FINANCIAL OPERATIONS: OPPORTUNITIES FOR INTER-AGENCY SYNERGY

A MONOGRAPH
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Abstract

Financial Operations: Opportunities for Inter-Agency Operational Synergy

by Major Michael F. Stollenwerk, USA, 111 pages.

Inter-state economic coercion is an ancient tradition among nations. Within the framework of economic statecraft, economic coercion manifests itself in three forms: Economic Warfare, Trade Wars, and Economic Sanctions. The empirical evidence on the efficacy of economic sanctions to accomplish foreign policy objectives is not very convincing - even some of the strongest academic proponents of economic sanctions conclude that they were historically effective only 34% of the time. However, financial sanctions (a subset of economic sanctions) appear to show more promise.

This monograph seeks to examine the efficacy of United States (US) financial operations at the interagency level. The primary research question is: Does the United States have an effective doctrine for conducting financial operations against both state and non-state actors? Financial operations link the application of specific financial restrictions, in concert with other elements of national power, to the strategic goals of the coercive campaign. This monograph concludes that it is possible to achieve operational art with financial operations at the interagency level if the Executive Branch is willing to centrally focus and synergize the energy of many players.

The US first exercised financial operations during World War I after Congress passed the Trading With the Enemy Act (TWEA) on October 6, 1917. During the post World War II era, the US employed financial operations to manage expropriation threats to US corporations from developing nations, notably in Latin America. The Hickenlooper and Gonzales Amendments gave the Executive Branch special powers and responsibilities in meeting threats of expropriation to US firms. US foreign policy with respect to Allende's Chile manifests such US concerns with expropriation, however, it also marks a transition point for US employment of financial operations to not just protect US assets, but to coerce other states as well.

Congressional approval of the International Emergency Economic Powers Act (IEEPA) in 1977 broadly expanded Presidential authority to employ financial operations. President Carter invoked IEEPA against Khomeini's Iran on November 14, 1977, seizing or blocking all Iranian assets in the US, as well as US banks overseas. The ensuing synergies of asset seizures, global litigation, and military pressure finally resulted in not only the release of the 52 American diplomatic hostages, but in Iranian payment of far more corporate financial claims against Iran than were due under law.

Subsequent to the US-Iran crisis, US Presidents have employed IEEPA eight more times, including most recently against Colombian drug cartels. US led multilateral financial operations against Iraq and Kuwait during and after the Gulf crisis saved Kuwaiti assets from Iraqi expropriation and greatly hurt Iraq economically. However, the results of the other uses of IEEPA are mixed, and in the cases of Panama and Haiti, clear failures. Analysis of these cases indicates that financial operations need to be integrated at the interagency level with the utmost attention by the Executive Branch.

This monograph proposes three initiatives to increase the efficacy of financial operations. The three initiatives are:

1. Seek to develop and refine financial sanctioning techniques and procedures that focus on target state political and economic elites.
2. Research and wargame new approaches to financial operations that may overcome time inconsistency when dealing with adversary states or non-state actors.
3. Initiate an interagency discussion on financial operations to improve crisis action coordination.

The twelve recommendations offered to implement these initiatives may require significant intellectual and cultural shifts in American economic statecraft, but these shifts will go far to leverage the potential of distributed financial operations. This monograph concludes that financial sanctions can be crafted to be more effective than traditional economic sanctions, and that financial operations, synergized with the potential for direct military action, can achieve national objectives that are beyond the reach of the other elements of national power.

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Table of Contents

			Page
Chapter 1	--	Introduction	1
Chapter 2	--	Economic Coercion and Interstate Conflict	8
Chapter 3	--	Financial Operations	21
Chapter 4	--	New Frontiers in Financial Operations	35
Chapter 5	--	Financial Operations and the Practice of Operational Art	46
Chapter 6	--	Summary, Recommendations, and Conclusions	54
Glossary			61
Appendix A	--	Hickenlooper Amendment (1962)	68
Appendix B	--	President Nixon's Statement on Expropriation Policy (JAN '72)	70
Appendix C	--	Gonzales Amendment (10 MAR '72)	73
Appendix D	--	Executive Order 12170 (Blocking Iranian Government Property)	74
Appendix E	--	Executive Order 12922 (Blocking Property of Certain Haitian Nationals)	75
Appendix F	--	Appendix 5: Executive Order 12978 (Blocking Assets and Prohibiting Transactions With Significant Narcotics Traffickers)	77
Appendix G	--	Office of Foreign Asset Control (OFAC) Web Site	80
Appendix H	--	Financial Securities and Derivatives	83
Endnotes			89
Bibliography			105

Chapter 1: Introduction

"For the most part, the study of defense problems [i.e., operational art] is not 'art for art's sake'."[1]
-Yale Economist Martin Shubik

United States (US) military intervention around the world has greatly intensified since the end of the cold war (see Figure 1-1). The Wall Street Journal's Bob Davis writes that "The US has been nearly continually at war since the cold war ended."[2] This seemingly extensive US commitment to militarily engage hostile powers around the world to advance its interests masks the larger role of US economic statecraft in US foreign policy. Each of the US military engagements shown in Figure 1-1 were preceded by, executed concurrently with, and then followed by extensive use of tactics of economic statecraft. The interaction of economic statecraft and military operations should interest military analysts and practitioners interested in the study and practice of operational art.

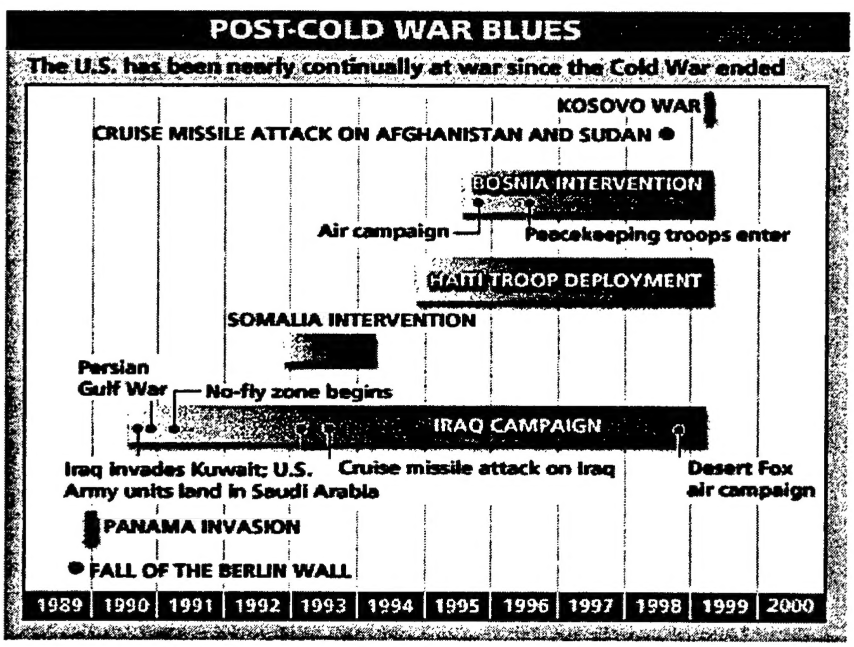

Figure 1-1 (US Military Engagements in the New World Order)[3]

Economic coercion and warfare is historically a ubiquitous feature of international relations. In one of the first recorded instances of economic warfare, Athens imposed an embargo against isthmus bound Megara in 446 BC after it revolted and killed its Athenian garrison. The embargo (the Megarian decree) drove Megara towards an alliance with Sparta, which then used the sanctions as an excuse to launch a war that ended Athenian supremacy of the Mediterranean in 405 BC.[4] During the Napoleonic era, the US had its first (post-revolutionary) experience with embargoes when in 1807 it banned US trade with all foreign ports after the "Chesapeake affair," a brutal British boarding of an American vessel at sea. President Jefferson loosened the embargo to include only France and Great Britain after the New England states threatened to succeed.[5] The practice of US economic statecraft has intensified in the twentieth century and impacts military operations.

This historical practice of economic statecraft has included various boycotts, blockades by sea, air, and land, raiding of merchant vessels, international sanctions, and direct attack on industrial and agricultural centers of gravity.[6] A related tactic has been the seizure of foreign assets in home nations. Sometimes nations resort to forms of economic coercion in lieu of armed conflict, while at other times nations undertake economic warfare during or after armed conflict. The US has employed economic sanctions extensively during this century both unilaterally and in multilateral contexts. More recently, the US has been frustrated in its ability to apply economic sanctions against non-state actors such as drug cartels and terrorist groups. Despite all of this "economic" activity, research and literature in the area of economic coercion seems thin.

Yale economist Martin Shubik observed that "It is surprising how small the literature is on economic warfare of any sort...One is hard put to find twenty books."[7]

The globalization[8] of the world economy makes economic coercion and warfare very complex. A political dispute between sovereign nations may occur despite the fact these nations' prosperity is dependent upon trading patterns amongst each other. Furthermore, the international diversification of ownership of assets complicates the issue of harming "national" economies because "national" companies and assets are internationally owned. The carrying out of economic forms of warfare against large states or major trading partners becomes domestically problematic, and thus much harder to signal credibly an intent to carry out economic conflict against an opponent.

A historic criticism of economic forms of warfare is that they are ineffectual because they are blunt methods that do not impact policymakers. Dartmouth's Robert Pape argues economic sanctions against unfriendly regimes such as Cuba and Iraq actually work to prevent internal change because the ability of ruling elites to allocate remaining scarce resources makes them even more powerful.[9] US economic sanction experiences in Haiti, Iraq, and Yugoslavia provided evidence that traditional economic tactics such as sanctions have become even less effective due to the ability of elites to profit from black marketing,[10] diversify their wealth abroad, and even profit on the manipulation information that may affect commodity prices. Military analysts such as Colonels Scharfen[11] and Doran[12] argue in two separate US Army War College papers that economic sanctions against Cuba and Iran are viewed as signs of weakness (i.e., a substitute for military action), and that rather than a signal of resolve, they are perhaps paradoxically worse than "doing nothing."

Another historic criticism of economic warfare and coercion is that the modern nation state is quite resilient,[13] and that economic pressure creates inhumane hardship and other unintended consequences. Shortly after World War I, future US Secretary of State John Foster Dulles opposed President Woodrow Wilson's advocacy of economic sanctions in the League of Nations on humanitarian grounds. During World War II, Germany and Japan withstood intense and repeated strategic bombing, yet remained functioning industrial powers despite the depraved conditions of their citizens. Furthermore, many historians argue that Japan was pushed into attacking Pearl Harbor by US economic sanctions.[14]

US policy in Haiti this decade illustrates many problems with economic sanctions. Brookings Institution's Richard Haass asserts that indiscriminate US economic sanctions against Haiti caused the human exodus to Florida that made military action necessary.[15] The 1991-1994 Haitian economic embargo caused the deaths of over 1,000 children per month, yet elites still shopped in Miami and received petroleum through the Dominican Republic (see Figure 1-1).[16] There is substantial evidence that economic pressure often results in severe and long lasting collateral damage to non-combatants (i.e., Haiti, post-gulf war Iraq, etc.) that may exceed legal standards of proportionality that would normally be applicable to US military forces under the Laws of Land Warfare.[17] University of Rochester's John Mueller and the US Air Force School of Advanced Airpower Studies' (SAAS's) Karl Mueller assert that economic sanction in Iraq alone since 1992 have killed more non-combatants than all weapons of mass destruction in history.[18]

Figure 1-1 (Effects of Economic Sanctions in Haiti)[19]

Many contemporary foreign policy initiatives seek to modify the behavior of non-state actors. Such actors are adept at using global financial systems to further their ends. For example, despite US missile attacks against the physical assets of Islamic fundamentalist leader Osama bin Ladin, his organization appears to retain sufficient liquidity to continue operating. In the wake of a recent failure to detect former Mexican President Carlos Salinas' indicted brother Raul's withdrawal of over $100 million from a Citibank account in New York, the US Office of National Drug Control Policy (ONDCP) and the US Department of Treasury have created a task force to look at defensive and offensive financial operations.[20]

This monograph seeks to explore the area of financial operations as a unique suite of economic statecraft that may avoid some of the pitfalls of traditional forms of economic warfare or sanctions. The term "operations" is used in lieu of sanctions because it implies more than a static one time application of an instrument of coercion. An operation implies a plan that is designed to counter possible target state counter moves, and to adapt to unanticipated target state actions. Financial operations link the application of specific financial restrictions, in concert with other elements of national power, to the strategic goals of the coercive campaign.[21]

It is necessary to approach the discussion of financial operations in stages. Economic sanctions are defined as a specific policy subset of economic statecraft. Financial restrictions (a tactic of economic statecraft) are explored primarily in the context of economic sanctions. In addition to describing traditional techniques and procedures[22] of financial restrictions, this monograph explores the concepts of "designer sanctions" and the national proprietary trading of financial securities and derivatives[23] (such as options, futures, forwards, swaps, and swaptions). Finally, the integration of financial operations into a campaign plan using the framework of military operational art is examined.

This monograph's purpose is to answer the question: "Does the US have an effective doctrine for conducting financial operations against both state and non-state actors?" The effort will review the historical evolution of financial operations, discuss their relevance and efficacy in the context of other economic sanctions, describe contemporary doctrine and execution of financial operations today, and seek to draw

conclusions and make recommendations to improve and synergize interagency conduct of financial operations.

The methodology specifically seeks to find:

- The degree to which US military and foreign policy institutions systematically identify and employ financial operations. To measure this degree, I will find and analyze the effectiveness of any discernible military or inter-agency planning procedures for identifying such policy options, and under what circumstances.
- The degree to which US military and foreign policy institutions integrate such policy options in an operational framework. To measure this degree, I will find and analyze the effectiveness of discernible doctrine or practice (or even initiatives in the field) to incorporate financial operations in campaign planning in order to achieve strategic objectives.

The analysis of these two aspects of financial operation will allow for the identification and analysis of any current doctrine or practice in this field. It will also provide the framework for exploration of the potential efficacy of financial operations within the framework of a campaign plan, particularly a military campaign involving stability and support operations and/or non-state actors. The conclusion of this monograph will relate financial operations to the contemporary theory and practice of operational art.

Chapter 2: Economic Coercion and Interstate Conflict

"I guess I should warn you, if I turn out to be particularly clear [regarding economics], you've probably misunderstood what I said."[24] -Alan Greenspan

"[Regarding US sanctions against Panama, America] ...had set the forest on fire to burn one tree." [25] -Jesse Jackson

Economic sanctions have increasingly become the foreign policy instrument of choice in the late twentieth century. US National Security Adviser Samuel (Sandy) Berger acknowledges that current US sanctions affect over seventy countries and half of the world.[26] More than twenty US cities and states have enacted their own form of economic sanctions on countries as diverse as Burma (political repression) and Switzerland (handling of Jewish property and financial claims).[27] For forty-five years, the UN employed economic sanctions only twice, but in the five years between 1990 and 1995, the UN resorted to this measure six times.[28] The US now undertakes sanction efforts at an average rate of three cases per year,[29] and US Presidents have invoked IEEPA to block assets and transactions nine times since 1979. Despite the fact that "economic sanctions are increasingly at the core of US foreign policy,"[30] empirical evidence tends to cast doubt on their effectiveness at achieving coercive goals. Pape's inductive Clauswitzian argument,[31] concludes that "The persistent failure of sanctions suggests that states' reasons for employing them must lie elsewhere."[32]

Economic sanctions are but one form of economic pressure. David Baldwin used the term "economic statecraft" in his 1985 book by the same name to encompass all forms of "...influence attempts relying primarily upon resources which have a reasonable semblance of a market price in terms of money.[33] However, Baldwin recognizes that in

regards to his definition of economic statecraft "...not everyone agrees that this is worthwhile."[34] Broadening Baldwin's definition of economic statecraft to include "all initiatives to influence a target state through manipulation of its economic well-being"[35] is analytically useful. Three accepted *forms* of economic statecraft are:

- **Trade Wars**: "...when a nation state threatens to inflict economic harm or actually inflicts it in order to persuade the target state to agree to more favorable terms of trade."[36]
- **Economic Warfare**: "[When a nation state]...seeks to weaken an adversary's aggregate economic potential in order to weaken its military capabilities, whether in a peacetime arms race or in an ongoing war."[37]
- **Economic Sanctions**: "[When a nation state seeks to change] the economic welfare of a target state by ...[affecting] trade in order to coerce the target government to change its political behavior."[38]

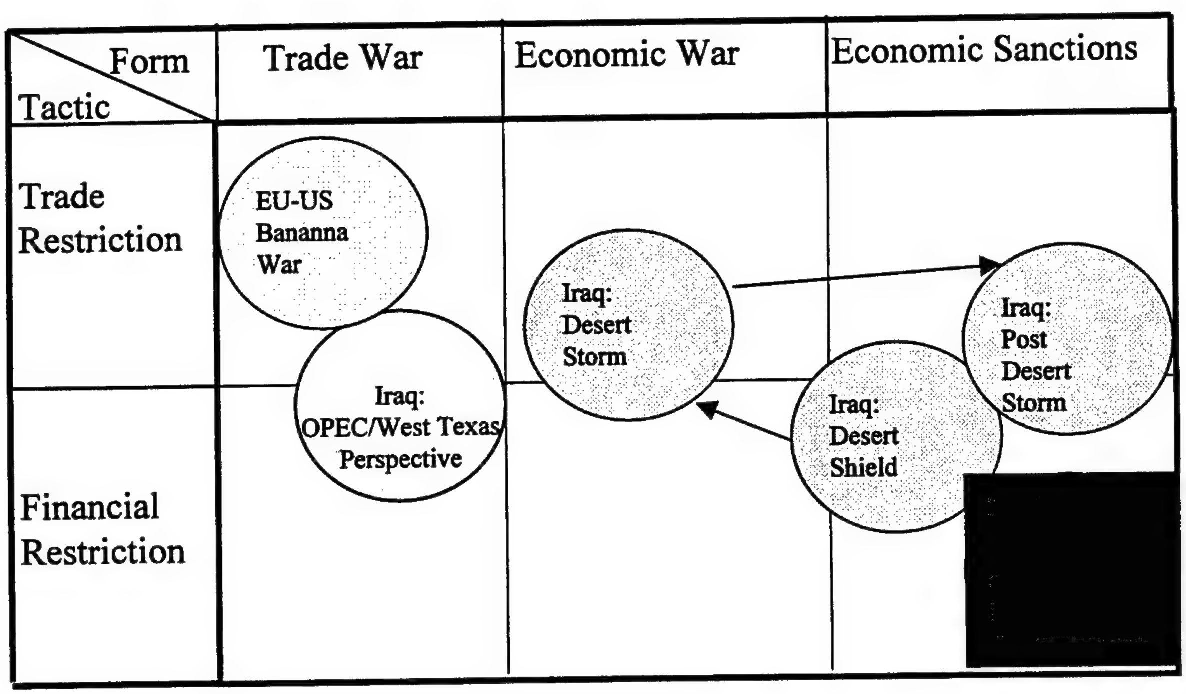

Figure 2-1 (The Complex Interdependence of Economic Statecraft)

The two economic *tactics* of economic statecraft are **trade restrictions** and **financial**

restrictions,[39] and these can be employed with varying degrees of severity, timing, and complexity across one or more of the three forms of economic statecraft separately or together (see Figure 2-1).[40]

The tactics of economic sanctions can provide either positive or negative reinforcement of target states' behaviors. Baldwin identifies seventeen different historical categories of US policy goals, and offers a partial list of "traditional" sanctioning techniques used to accomplish these goal sets (see Figure 2-2).[41] A "restriction" can be positive reinforcement if it affects other states to the target state's benefit, or if it is reduced on the target state's behalf. Definitions of each technique are offered in the Glossary.

	Trade Restrictions	***Financial Restrictions***
Negative Sanctions	**Embargo, Boycott, Tariffs, Blacklist, Quotas, Preclusive Buying**	**Freezing Assets, Capital Controls, Aid Suspension, Expropriation, Taxation, Withholding Taxes**
Positive Sanctions	**Tariffs, Direct Purchase, Subsidies, Providing Aid, taxation**	**Providing Aid, Investment Guarantees, Taxation.**

Figure 2- 2 (Traditional Economic Sanctions)

Trade Wars

Trade wars are relatively common and are reported prominently in the press. The US and Japan have periodically engaged in brinkmanship-like behavior over selected trade issues since the 1970s.[42] The US and the European Union (EU) are currently engaged in a "banana war" over preferential treatment by the EU of banana imports from former EU colonies, to the detriment of US companies such as Dole and Chaquita. On

April 20, 1999, the World Trade Organization (WTO), successor organization to the General Agreement on Tariffs and Trade (GATT), authorized the US to go ahead with punitive 100% tariffs on $191.4 million worth of EU exports to the US. This was the first such action ever taken by the WTO, and only the second time since the inception of GATT a half century ago.[43]

In a trade war, nations respond "tit for tat" for an extended period of time. The nation of Panama approved of the WTO ruling noting that the EU has never backed down on agricultural issues except in response to the "...credible threat of commercial sanctions."[44] On April 21, 1999, the European Commission (EC) of the EU retaliated to the WTO ruling on bananas by threatening to block hormone free beef imports from the US, despite the fact that the EU is already in violation of WTO directives to cease its 1989 ban on importation of US hormone treated beef.[45] Fortunately, only in novels such as Tom Clancy's *Debt of Honor* has a trade war ever turned into a shooting war.[46]

Economic Warfare

Economic warfare (including such activities as naval Blockades and the bombing[47] of industrial centers) is a supporting component of a coercive strategy based on force. Attacks on the economic centers of gravity of a target state are designed to weaken it militarily (see Figure 2-3). Logically, an action such as a blockade may be an element of both economic sanctions and economic warfare; that is, they may contribute to the military war effort, as well as be a separate coercive policy measure outside the use of force.[48] However, this would imply that a sanctioning state expects the target state to comply with political ultimatums due to purely economic duress, even though that state may have already chosen to go to war rather than comply.[49] Finally, consider the fact that

economic trade between *belligerent* states may still occur, especially if the terms of trade are very favorable to both sides.[50]

Figure 2-3 (Economic Warfare in Operation ALLIED FORCE)

Economic Sanctions

Economic sanctions are very distinct from trade wars and economic warfare in that they are designed to achieve a political goal solely through the application of economic manipulation (usually pain). Donald Losman[51] of the Industrial War College of the Armed Forces writes that

> One must recognize that sanctions involve two distinct processes, one economic and one political. Sanctions are a nonmilitary form of coercion designed to inflict economic damage. To impose meaningful economic distress, then, is a necessary condition for success, but hardly a sufficient one. That distress then must be translated via the target state's political system into the desired policy changes. Failure in a either process will nullify the effort.[52]

Despite the emphasis on inflicting pain through two distinct and uncertain mechanisms, economic sanctions are commonly employed quickly in a crisis by the US and other nations, and more recently, the UN.

Part of the popularity of sanctions in the late twentieth century stems from the fact that they seem to offer policy makers tools of inter-state leverage independent of the use

of force. For example, the "Powell doctrine" specifically called for the use of force only after policies such as economic sanctions had been given a chance to work.[53] Despite the policy popularity of economic sanctions, their efficacy remains a very contentious topic in the study of international relations.

The Efficacy of Economic Sanctions

One of the largest and most cited empirical studies on the effectiveness of economic sanctions is the 1990 book *Economic Sanctions Reconsidered: History and Current Policy* by Gary Hufbauer, Jeffrey Schott, and Kimberly Elliott (this study shall be referred to as HSE). This "large N study"[54] involves analysis of 115 cases of economic sanctions since 1914. The authors analyze and rank the effectiveness of sanctions in achieving the political goal of the sanctionor. HSE concludes that of the 115 cases of sanctions, there are 40 successes, or 34% of the total.[55] HSE concludes that sanctions have utility in altering the political behavior of target states.

Pape and many others take issue with HSE's conclusions. In a detailed refutation of the coding of HSE's data set, Pape argues that HSE double count some cases of sanctions, and that they coded many sanction failures as successes (see Figure 2-4). For example, Pape argues that 18 of the 40 HSE successes were really a result of a major use of directly coercive force, hence sanctions failed by definition in achieving a political outcome. According to Pape, sanctions have been effective only 5% of the time, thus confirming

> ...that the old conventional wisdom was right: there is little valid social science support for claims that economic sanctions can achieve major foreign policy goals.[56]

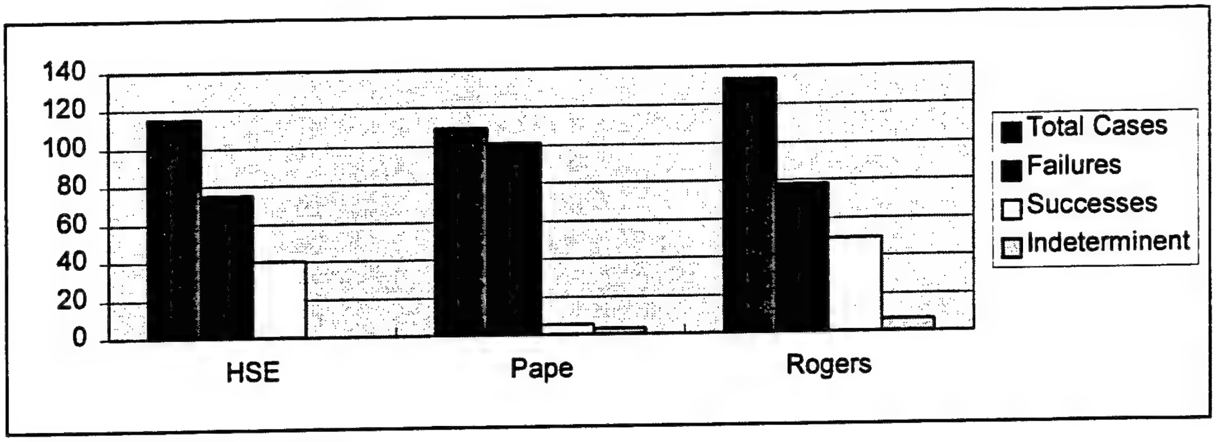

Figure 2-4 (Efficacy of Economic Sanctions: HSE vs. Pape; Rogers Update)

Harvard's Elizabeth Rogers disagrees with Pape's dissection of HSE, and goes on to update the HSE data set with analysis of eighteen more economic sanction incidents since the 1990 HSE study during the summer of 1996. Rogers' research argues that sanctions should be applied full force and early on in a crises, that financial restrictions are the strongest economic tactic, and that all economic sanctions should be focused on target regime elite actors.[57] She finds that of three of these efforts are failures, nine are fully or partially successful, and six are indeterminent. Her coding of the events is generous to sanctions' efficacy in the spirit of HSE. For example, Rogers calls sanctions against Haiti a success (see Figure 2-5), arguing that "....sanctions softened up Haitian elites,"[58] without noting that Haitian coup leader Raul Cedras stepped down from power only after confirming that the US had physically launched the largest airborne invasion since Operation MARKET GARDEN.[59]

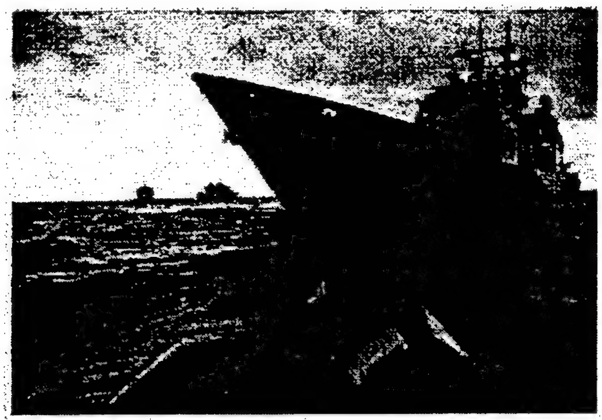

Figure 2-5 (US Naval Enforcement of Economic Sanctions in Haiti)[60]

In addition to the controversy involved in correctly coding the data set, the debate over the efficacy of sanctions is clouded by other issues. One problem is the methodological complexity of evaluating sanctions. Policy makers may choose sanctions for a variety of reasons, and perhaps none of these reasons involve the serious expectation that economic sanctions would accomplish any stated or implied coercive goal. Furthermore, sanctions may lead to outcomes that are *worse* than the status quo ante, let alone a mere failure to fulfill any stated desire of the implementing state or states.[61]

Sanctions can satisfy constituencies of domestic political elites. In international confrontations, policy makers (especially elected officials) may feel the need to "do something" in order to appeal to the sensitivities of a particular groups (i.e., the Black Congressional Caucus during 1994 regarding US policy on Haiti) or the public at large. Furthermore, economic sanctions can create economic opportunity for selected groups. For example, the Helms-Burton Act (forbidding trade and other contacts with Cuba) has been called the "Florida Primary Act" because it appeals to Cuban-American voter antipathy towards Castro's Cuba, and perhaps equally important, opens opportunities for litigation of financial claims by Americans against the Cuban government (see Figure 2-

6). Satisfaction of domestic constituencies with economic sanctions is not normally a criteria for studying the efficacy of sanctions because the normative bias of these studies is usually to prove or disprove that sanctions are a means to coerce other states (i.e., in Clausewitzian terms, a continuation of policy by other means <u>besides</u> war).[62]

Figure 2-6 (Cuban Economic Hardship and Adaptation)[63]

States may use sanctions to send complex signals. The sanctions signal resolve to the target state that the sender is serious about its political objective to disrupt domestic well being via the trade lever. For example, Baldwin offers that US action to impose and maintain cultural and economic sanctions against the Soviet Union after their 27 April, 1978 invasion of Afghanistan was not to get them to leave that country,[64] but rather to send a signal that we object, and that further aggression would be countered more forcefully. Hufbauer calls economic sanctions "harbingers" of future action once a domestic and/or international policy consensus develops.[65] Furthermore, signals of this type are often meant to warn (or comfort) other states in the international system.

Perhaps more importantly, economic sanctions may be part of an elaborate policy ritual performed by policy elites in order to garner support (or at least acquiescence) from

the public and potential allies for military action. Baldwin describes this signaling outcome as legitimacy.[66] The idea is to legitimate the sender state's entreaties to other states - it would be had to do this if the US was carrying on business as usual with the target state.[67] Thus, in this respect, economic sanctions do not have to be viable as options to achieve the policy goal themselves; they just have to be perceived as valuable and prudent escalatory steps by the "true" targets of the action - potential allies, onlooking neutral countries, as well as a war reticent public. The military planning realities of this sort of escalatory signaling ritual within NATO was reinforced by Spring 1999 experiences of School of Advanced Military Studies (SAMS) students deployed to assist US European Command (EUCOM) develop contingency plans for a ground war sequel to Operation ALLIED FORCE.[68] US Army Major (and 1998/99 SAMS student) Wayne A. Green remarked that "...NATO escalation was not a strategy against Serbia, but rather a necessary internal mechanism to achieve political consensus within NATO."[69] Testing the effectiveness of sanctions under these hypotheses would test not response of the "target" state, but rather test the effect of the sanctions on the resolve of allies, domestic institutions like Congress, and the public at large.

Black Nights

Baldwin and others define "black nights" as states that interfere with a sanction regime by supporting the target state.[70] The Soviet Union and China often played this role during the Cold War (e.g., Cuba, Vietnam). More recently, Canada and the EU can be viewed as black nights with respect to US Cuban sanctions policy. Contemporary criticisms of economic sanctions (such as included in the Muellers' *Sanctions of Mass Destruction* and Haas' *Sanctioning Madness*) describe them as generally far too effective

in the post cold war era due to the absence of black nights. These and many other authors argue that contemporary economic sanctions regimes with respect to Iraq, Serbia, and elsewhere cause too much human misery considering their tangential role in achieving political objectives. Gregory F. Gause III argues in *Getting It Backward on Iraq* that UN sanctions should be *relaxed* to create the conditions to achieve counter-WMD objectives. Perhaps the general issue here is that in the post cold war era of no black nights, the US may need to purposely construct *less* restrictive sanctioning regimes than it attempted during the Cold War.

Unintended Consequences of Economic Sanctions

Sanctions may lead to many unintended consequences, including war. To counter Japanese military aggression in East Asia, the US invoked two rounds of economic sanctions against Japan in the 1930s, and initiated a third round in July of 1940 that froze Japanese assets, and cut off all trade including oil. Some scholars argue that these sanctions directly led to the Japanese decision to attack the United States on December 7, 1941. For example, Henry Bienen and Robert Gilpin report that

> "...the application of an oil boycott against Japan in August 1941 is the most momentous example of the dangers and ultimate ineffectiveness of economic sanctions. The oil boycott not only failed to achieve its purpose of deterring Japan, but it triggered the Japanese attack on Pearl Harbor and the second world war in the Pacific...From this perspective, sanctions were not only ineffective, but counterproductive in that they stimulated aggression in South-East Asia and against the United States itself."[71]

Unless one were to believe that the true aim of the US was to induce this attack,[72] then researchers have a difficult statistical problem to deal with since not only did sanctions <u>not</u> work, they resulted in a worsening of the status quo ante.[73]

Some US policy elites recognize risks in imposing economic sanctions. Former US Secretary of Defense William Perry (and special advisor to President Clinton on North Korea) warned on March 22, 1999 that:

> ...the use of economic sanctions to stem nuclear proliferation in the Korean Peninsula and the Indian subcontinent could backfire. Sanctions might further alienate countries developing nuclear arsenals and convince them to rely on nuclear tactics as a measure of might.[74]

Perhaps underscoring Perry's analysis is the fact that the first and only wartime use of nuclear tactics occurred in a war thought by some historians to be caused by US economic sanctions. Application of this risk calculus to relations with non-nuclear states would lead to greater general reluctance to use economic sanctions.

Summary and Conclusion

Studying the efficacy of economic sanctions is very problematic. Policy makers may apply sanctions with many different goals in mind than merely deterring or coercing states. The evidence shows that sanctions are historically not correlated with visible political success, may have unintended consequences, and when they *are* correlated with political success, it is very hard to statistically prove that sanctions are responsible for the successful policy outcome. A related problem is a general academic bias that assumes that sanctions are generally a plausible policy substitute for military or other action.[75]

Economic statecraft is always a complex interdependent policy. In addition to the many problematic issues involved in employing or even studying economic sanctions, nation states often find themselves using multiple elements of economic statecraft simultaneously at cross purposes with different national strategic and domestic objectives. Furthermore, alliances waging economic statecraft often lack unity of effort.

Operations ALLIED FORCE and DESERT SHIELD/DESERT STORM illustrate these issues in economic statecraft.

The complex interdependent nature of the US orchestrated economic statecraft against Iraq is illustrated in Figure 2-1. During Operation DESERT SHIELD, economic measures were structured as sanctions, weighted heavily toward financial restrictions. Operation DESERT STORM shifted the focus toward economic war and emphasized trade restrictions. Economic coercion in the post-Safwan Airfield agreement era has been to indefinitely continue economic sanctions until Iraq fully complies with UN demands for complete and verifiable disarmament in the areas of weapons of mass destruction (WMDs). As was the experience with Haiti, target state populations suffer while policy objectives remain unresolved.

Now consider the situation in the Balkans in the Spring of 1999: The US and its (mainly EU member) NATO allies are waging a shooting war against Yugoslavia in part because economic sanctions failed to stop Serbia from waging ethnic aggression throughout Yugoslavia. NATO continues to support economic sanctions, but these sanctions are now primarily a form of economic warfare, however, France blocks attempts to employ a naval blockade to embargo oil from reaching Serbia through Montenegro, another province of Serb dominated Yugoslavia.[76] Meanwhile, the allies face off <u>amongst themselves</u> in a trade war over bananas and hormone induced beef. Clearly, economic phenomena remain a complex social science, prompting US Federal Reserve Chairman Alan Greenspan to once comment that "I guess I should warn you, if I turn out to be particularly clear [regarding economics], you've probably misunderstood what I said."[77]

Chapter 3: Financial Operations

"[In Chile, we are]...making the economy scream."[78] -Henry Kissinger

"Financial sanctions are more likely to hit the pet projects or personal pockets of powerful government officials who are in a position to influence policy."[79] -Gary Hufbauer and Kimberly Elliott, Georgetown University

The US has a long history of employing financial restrictions.[80] The first flexing of growing American financial power occurred in 1911 when US banks withheld a loan from China to demonstrate American neutrality towards competing Chinese political factions. This step exercised "...an informal and extra legal relationship between the department of state and the [US] banking community."[81] The US again used financial restrictions against China in 1913, against Ecuador in 1917, and against Mexico in 1916 and 1917. These actions occurred before the passage of the Trading with the Enemy Act (TWEA) in 1917 which gave the President the ability to declare financial emergencies and to undertake financial restrictions such as asset freezing. The informal relationship between the US executive branch and the US financial community prompts Yale's B. J. Cohen to write that "High finance has always been connected with high politics."[82]

The relationship between high politics and high finance underwrote the twentieth century US foreign policy that specifically sought to protect American global financial interests. The early action against Ecuador in 1917 was in response to a commercial dispute. After World War I, President Harding invited leading bankers to a cabinet meeting to formulate long run policies to deal with possible European sovereign default on war bonds and other debt.[83] Following World War II, US politico-finance policy focus shifted toward managing threats of expropriation of US property by developing nations

(see Figure 3-1). Following Cuban President Fidel Castro's expropriation of American property in Cuba, Congressional pressure on the executive branch to meet expropriation threats led to the 1962 Hickenlopper Amendment (see Appendix A) and the 1972 Gonzales Amendment (see Appendix B). President Nixon's policy statement on expropriation in 1972 (see Appendix 3) illustrates the US fixation on meeting threats to expropriation even if at the expense of other foreign policy goals. Partly in response to escalating Chilean expropriation of US property in Chile, the US supported a 1973 military coup to topple its Marxist government headed by Salvador Allende.

Expropriation in Latin America (1900-1971)		
Year	**Country**	**Property Seized**
1917-1920	Mexico	Land
1937	Bolivia	Oil
1938	Mexico	Oil
1952	Bolivia	Oil, Tin Mines
1952	Guatemal a	Land
1959-1960	Cuba	US Interests/Whole Economy
1959, 1962	Brazil	Several Public Utilities
1968	Peru	Oil, Some Land and Businesses
1968 & 1971	Bolivia	Oil, Zinc Mine
1970-1971	Chile	Copper Companies, Land, Other Holdings
1971	Guyana	Bauxite Concession

Figure 3-1 (Expropriation in Latin America, 1900-1971)[84]

Recent practice of financial operations has shifted away from counter-expropriation toward use as an instrument of economic coercion to accomplish other political objectives. Hufbauer and others write the financial sanctions are more flexible and adaptable, less offensive in humanitarian terms, focus pressure on target political elites, open fewer opportunities for unintended beneficiaries (i.e., black market

profiteering), work on targets with less foreign trade, and that the effects of financial operations can be "contagious," thus inducing de facto extra territoriality of US actions.[85] This contagion effect has been demonstrated in numerous historical financial panics, but it is also related to legal litigation by firms and governments, as happened against Kohmeini's Iran.

US financial sanctions benefit from bureaucratic "unity of command" because they are implemented by essentially one entity: The US Department of Treasury. Treasury enjoys an influential formal and informal presence in many interagency bodies, as well as private institutions in the US financial industry. This creates a myriad of policy options. For example, the Treasury can influence the Interagency Country Exposure Committee (ICERC) to downgrade a country's risk rating, even in the absence of a declared national emergency. Such influence stems in part from the tendency of Treasury department political appointees to be drawn from the highest echelons of private sector finance. For example, former US Treasury Secretary Robert Rubin was previously the managing partner of Goldman, Sachs, Wall Street's last privately held investment bank.[86]

Contemporary US experience with financial operations is mixed. Since the passage of IEEPA in 1977, the US use of financial restrictions has generally been as relatively ineffective as trade restrictions in achieving US objectives. However, in the cases of Allende's Chile, Kohmeini's Iran, and Operation DESERT SHIELD/DESERT STORM, financial restrictions were extraordinarily successful (see Figure 3-2). In these three cases, the executive branch employed financial operations with extraordinary focus,

achieving US political and economic objectives, including some objectives that could not have been achieved by military force.

Contemporary Financial Operations Scoreboard					
		Result			
Year	***Case***	**Failure**	**Success**	**Bonus**	**Source**
1973	Chile		X		HSE
1979	Iran		X	X	HSE
1985	Nicaragua	X			HSE
1986	Libya		?		WSJ
1988	Panama	X			DRB
1990	Iraq (DS/DS)		X	X	Rogers
1991	Iraq (WMD)	X			Rogers
1991	Haiti	X			Haas
1994	Rwanda	X			Rogers
1996	Cali Cartel		?		McCaffery
1999	Narcotics Money Laundering		?		McCaffery

Figure 3-2 (Efficacy of Contemporary Financial Restrictions)

Allende's Chile

US distributed financial operations against Chile in the early 1970s were instrumental in achieving US political objectives. Between March and October of 1973, US Secretary of State Henry Kissinger[87] and President Richard M. Nixon coordinated a synergized campaign of distributed financial operations to first block Allende's election, and then when that failed, to destabilize his regime. Nixon ordered the Central Intelligence Agency (CIA) to provide significant covert support including direct campaign contributions to opponents of Chilean Socialist Party presidential candidate Salvador Allende, the twice defeated (once with CIA help) proponent of foreign

industrial nationalization and redistribution of wealth in Chile.[88] Welcoming corporate support for the US effort, Nixon allowed the CIA to discuss the campaign with executives of International Telegraph and Telephone (ITT) corporation, who wanted to coordinate their own aid to opponents of Allende with the CIA as they had done in the past in Chile.[89] Kissinger telegraphed the scope and intensity of the intent of the financial operations campaign through several means to the executive branch and others. In addition to his "40 Committee" (a CIA oversight group chaired by Kissinger) efforts, he publicly stated on June 27, 1970 that "I don't see why we have to stand idly by and watch a country go communist due to the irresponsibility of its own people."[90] Despite US covert action, Allende wins the presidency narrowly on September 14, 1970.

On November 9, 1970, Nixon issued Presidential Decision Memorandum (PDM) 93 that calls for coordinated financial pressure on Chile. Kissinger continued to personally coordinate US foreign policy actions that facilitated the eventual overthrow of the newly elected Chilean President Allende. As part of this coordinated effort, US Secretary of the Treasury John B. Connally cut off foreign credits and aid to Chile (such as Export-Import (Ex-Im) Bank credits), but *not* its military. Kissinger's 40 Committee continued covert action to destabilize Allende's government.[91] In an example of Hufbauer's financial contagion, private US banks drastically reduced Chilean credit lines. US pressure on world financial institutions such as the IDB and World Bank (where Kissinger proposes to "make [Chile's] economy scream"[92]), resulted in most loans and loan requests being deferred or rejected. In September of 1971, Allende nationalized Kenecott and Anacoda Copper mining concerns and dictated compensation terms.

Several months later, Allende postponed payments on its sovereign debt to foreign governments.

Private legal action against Chile in France and other European countries by Kennecott and Anaconda and "Paris Club" creditors (foreign governments seeking to make Chile fulfill debt obligations) increased the financial contagion afflicting Allende's Chile. Despite action by European and International Monetary Fund (IMF) black nights to sterilize some of the effects of financial restrictions, Chile's economy and domestic situation continued to deteriorate. The US Congress passed the Gonzales Amendment (see Appendix C (Gonzales Amendment)) in March of 1972 instructing US representatives on any international body to vote against international loans for countries that nationalize foreign assets. University of Sussex's Emmanuel de Kadt and Paul E. Sigmund fault Allende for text book economic mismanagement, and other actions that incited intense internal opposition,[93] but it is reasonable to assert that external financial pressure on Allende contributed to his own destructive policies.

On September 11, 1972, Allende was assassinated during a successful military coup led by Chilean army general Augusto Pinochet Uguarte. US and US-led financial institutions such as the IDB extended $636 million dollars in credit to Chile within two months. Chile agreed to compensate copper companies and meet debt obligations, and by March of 1974, the financial contagion subsided as private and public lending to Chile resumed to pre-Allende levels. Pinochet so brutally suppressed the communist threat that worried Kissinger, that the US Congress later imposed its own financial sanctions against Pinochet's Chile.

Khomeini's Iran

US distributed financial operations against the revolutionary government of Iran under Allotollah Ruhollah Khomeini not only achieved US political objectives, but obtained financial concessions for US corporations in excess of contractual obligation. A long time US ally in the Persian Gulf region, Shah Mohammed Reza Pahlavi fled Iran on January 16, 1979 in the midst of a fervent fundamentalist revolutionary challenge to his regime. Within a month, the exiled Khomeini returned to Iran and installed a revolutionary government. Racked with anti-American sentiment. Iranian students briefly took the US embassy and its personnel hostage, releasing them at the direction of Khomeini loyalists.[94] In response to US efforts to find the Shah a safe haven in Panama, students again seized the embassy and its personnel hostage on November 4, 1979, igniting an international crisis.

In response to this "national emergency,"[95] President Jimmy Carter invoked IEEPA for the first time in US history to freeze Iranian assets. During the reign of the Shah, Iran amassed $14 billion of "petro-dollars" and other property, much of it deposited in US and Eurodollar accounts.[96] A Eurodollar account is any account denominated in dollars in a financial institution outside the US. The Eurodollar market was and remains a way for financial institutions to get around US Federal Reserve Board Regulations D and Q that set reserve requirements and interest rate ceilings. Many countries, including Iran, believed that Eurodollar markets were outside of US law, and by implication, IEEPA. For practical purposes in this crisis, they were wrong.

Carter's National Security Advisor Zibigniew Brzezinski personally coordinated a vast array of US interagency and multilateral pressure on Iran. At least one US Navy carrier battle group loitered off Iranian shores during the entire crisis. Just as

significantly, David Rockefeller (assisted by Kissinger, now in private life) of Citibank (and a long time friend of the Shah) personally coordinated financial and legal responses by US banks and firms that paralyzed Iran's finances in world courts.[97] Citibank and other banks such as Bankers Trust (BT) moved Iranian deposits to US branches, and offset the deposits against Iranian loan obligations. In a type of financial contagion, other creditors began calling Iranian loans, making them in default as Iran could not pay with its frozen accounts. Iran challenged the extra-territoriality of the asset freeze in British courts. The US government, Citibank, and virtually all Iranian creditors, argued a many layered technical defense of the freeze. One major aspect of this complicated defense was that almost all disbursements of Eurodollar deposits go through the Clearing House Interbank Payment System (CHIPS) in New York, thus IEEPA would apply to the deposits at that stage of any payment.[98] In addition to the technical nature of the litigation, British courts were essentially un-inclined to make any rulings as long as Iran was still holding hostages.

Carter and Brzezinski continued to escalate pressure on Iran through diplomacy, further economic and cultural sanctions, and finally a failed military rescue mission on April 25, 1980, the same month that the Shah died in Egypt. On September 22, 1980, the Iran-Iraq border dispute became a shooting war. Regional Iranian military superiority under the Shah had eroded due to Iranian financial duress and lack of access to US military spare parts, technicians, and equipment. After Carter's electoral defeat in November, the Iranian parliament issued a set of conditions for the release of the hostages that included demands for return of the Shah's wealth, the ending of economic and financial sanctions, and a US promise of non-interference in Iranian affairs. The Algiers

accord on January 19, 1981 formalized an agreement for ending the crisis that not only achieved US political objectives, but obtained tremendous leverage for US and other nations' financial and business interests to settle claims against Iran. Iranian Bank Markahzi Iran (BMI) economist Mahvash Alersool concludes that "Iran agreed to compensate the US claimants to a degree unprecedented in any compensation program after a war or revolution."[99] US distributed financial operations not only achieved the release of the hostages, but advanced US financial interests in ways that military forces could not.

Operation Desert Shield/Desert Storm

Iraq invaded Kuwait[100] on August 2, 1990, prompting US President George Bush to immediately wage a distributed multi-lateral financial operation against Iraq and more interestingly, against Kuwait. Invoking IEEPA, the US seized assets and banned all trade except food and medical supplies. Bush sought to add breadth to these sanctions with diplomatic initiatives that resulted in a European Community (EC) trade embargo and asset freeze on August 4, followed by Japanese trade and foreign aid sanctions on August 5. On August 6, the UN Security Counsel imposed its own set of financial sanctions against Iraq and Kuwait, making the force of financial sanctions essentially law throughout the globe.[101] In essence, allied and UN economic sanctions resolutions gave US IEEPA sanctions extraterritorial application - no national courts interfered with any private banking actions taken to enforce IEEPA against Iraq and Kuwait.

Multi-lateral financial sanctions were a pre-cursor to future military allied cooperation against Iraq. The sanctions put on motion a series of institutional steps around the world that signaled Iraq as a pariah state and eliminated Iraqi financial

freedom of action to prepare for war. The trade "sanctions induced hyperinflation, and the prices of basic staple goods skyrocketed, placing most Iraqis outside the food market."[102] Desperate for "off balance sheet" financing, the Iraqi's sought help from former enemy Iran, bartering planes and other materiel for war supplies. But the crucial interaction effect of the multi-lateral economic sanctions efforts was the long term effects from the distributed financial operations initiated by Bush. Kuwaiti assets were protected from confiscation, while Iraqi assets were at risk in the event of war for reparations or demands for post conflict political concessions. Without firing a shot, these distributed actions changed Iraqi war calculus, helped gestate an allied military coalition, and created bargaining power that could be used against Iraq during and after the war.

The "Failures"

Many recent "failed" attempts to influence states through financial sanctions ca be characterized by lack of a distributed framework in their application (see Figure 3-2). US financial pressure on Nicaragua in 1985 was largely sterilized by European and Canadian white nights. Despite US Secretary of State George Shultz efforts to influence international financial institutions to support US anti-Communist policy goals, US actions were unilateral and lacked depth and synchronization with other elements of national power.[103] US and UN financial sanctions[104] against Libya for sponsoring terrorism and harboring terrorists in 1986 did not seem to affect Libyan actions under its leader Colonel Muamar Gaddafi until April of 1999 when Libya suddenly and inexplicably complied with demands to turn over terrorists for trial,[105] prompting The Wall Street Journal (WSJ) to ask "What made Mr. Gadhafi [alternate spelling] give in?"[106] US unilateral financial sanctions against Panama in 1988 crippled the Panamanian

economy, but failed to achieve effective linkage with covert and military efforts to foment a coup or remove Noriega and the Panamanian Defense Forces (PDF) from power.[107] UN pressure on post-war Iraq in 1991 to control WMD potential failed to produce compliance with post-war demands. US financial sanctions on Rwanda in 1994 were ineffective in attenuating ethnic violence. US financial sanctions in Haiti were also seemingly incentive, but this case deserves more careful attention.

Haiti

US financial operations in Haiti exhibited innovation without policy focus. After years of "on-again off-again" US economic sanctions, President William Clinton invoked IEEPA in 1994 against not just the Haitian government, but against Haitian military and economic elites *by name* (see Appendix E (Executive Order 12922)). The policy goal was to get the Haitian military junta to step aside and allow Jean-Bertrand Aristide to return as Haiti's elected president. Although clearly overshadowed by the subsequent launching of a US airborne invasion, Rogers credits these sanctions with convincing Haitian elites that they would have to accept Aristide.[108] General (Ret.) Colin Powell observed otherwise just before the US launched its (later aborted) invasion:

> What struck me was how sleek, fell fed, and well dressed these men looked after almost three years of sanctions had impoverished their country men. So much for sanctions.[109]

The 82d Airborne Division commander, planning staff, and Army historians were unaware of any attempt to link execution of these designer sanctions with military combat tasks, despite unit orders specifying capture or neutralization of specific Haitian elites by name.[110] Perhaps the most significant innovation in financial operations was US use of positive designer sanctions - lucrative golden parachutes for Haitian military elites.

Joint Task Force Commander Lieutenant General Henry "Hugh" Shelton's first task on arrival to Haiti was to safeguard Haitian military elites[111], so that they could proceed to access their now unfrozen bank accounts, receive safe passage and living expenses to their new pre-paid (US leased) luxury quarters in Panama, and enjoy reimbursement for moving expenses and expenses incurred in possible future moves.[112]

Non-State Actors

US experimentation with designer financial sanctions against drug traffickers is one of the latest US attempt to achieve policy goals with financial operations. Clinton invoked IEEPA against members of the Colombian Cali drug cartel in 1995 (see Appendix F (Executive Order 12978)). The Treasury Department's Financial Enforcement Center (FINCEN), in close coordination with the US Office of National Drug Control Policy (ONDCP) and other agencies, is currently actively pursuing US counter-drug policy goals with innovative strategies to employ designer sanctions by leveraging new technologies such as expert systems and nodal analysis. FINCEN established a Financial Actions Task Force (FATF) to coordinate inter-agency efforts in the area of international money laundering. In April of 1999, FINCEN issued a banking "public notice" against Antigua and Barbuda for lax enforcement of money laundering laws with respect to narcotics traffickers, prompting target governments to consider changing their policies.[113] FINCEN's 1998 Project EL DORADO limited allowable cash wire remittances to $10,000 from the New York Borough of Queens to Columbia - the effort forced narcotics traffickers to move cash through mail bundles which is costly and often intercepted by Customs agents.[114] ONDCP's Director, General (Ret.) Barry

McCaffery is optimistic about the effects of these counter drug financial operations, but is not ready to conclude that their effects will prove indefinitely decisive.[115]

US inter-agency efforts to counter terrorism are also seeking to leverage financial operations. PDD 62 designated the Treasury Department as a lead agency in counter-terrorism. FINCEN has designated twelve groups, entities, and individuals as specially designated terrorists (SDTs) in an attempt to thwart their ability to access world financial markets.[116] Due to the classified nature of this topic, there is little basis upon which to analyze the efficacy of these actions. One technical problem with the current inter-agency financial approach to countering terrorism is that the US intelligence community has been unwilling in several cases to reveal sources of information in order to meet legal requirements for SDT designation. The result was that these individuals were not designated at SDTs.[117] Further evidence of lack of financial synergism with respect to counter-terrorism is illustrated by the dubious validity of US intelligence used to target Sudanese properties allegedly belonging to assets of Islamic terrorist leader Osama bin Ladin on August 21, 1998.[118] McCaffery's very cautious estimate of the contemporary efficacy of financial operations against drug traffickers seems to apply generally with respect to non-state actors.

Summary

Contemporary employment of unilateral US and multilateral financial operations shows great promise in helping to achieve political objectives using economic statecraft. The cases of Allende's Chile, Khomeini's Iran, Iraq (1990) point toward high efficacy of distributed financial operations. Key factors in their successes were strong involvement by the executive branch, significant financial exposure of the target countries, and

coordinated action with US industry and multi-lateral institutions. The case of Cedras' Haiti illustrates the utility of designer sanctions, particularly positive ones (golden parachutes). US financial operations against non-state actors display inter-agency innovation, but have not yet proved decisive. More research in this area of economic statecraft is needed to develop more durable and effective designer sanctions, as well as a modern theory of distributed financial operations.

Chapter 4: New Frontiers in Financial Operations

"Consider the legend of Nathan Rothschild shorting the French market upon hearing almost a week ahead of time that Napoleon was defeated at Waterloo."[119] **-Andy Kessler, Partner, Velocity Capital Management**

Lenin believed that the subversion of a county's monetary system was an important act of warfare.[120]

"Forget symmetry, think 'crazy'!"[121] ***-Martin Shubik, Yale University***

US financial operations are historically passive in nature - that is, they normally depend on the conditions of the target state. The freezing of foreign assets at home and abroad, the stoppage of foreign aid, and the blocking of foreign investment flows are all acts that depend on the exposure of the target state to these actions. Baldwin defines financial exposure as the degree of assets held by the government and elites in foreign assets in locations where they can be frozen, as well as level of general integration in world trade.[122] If they are less exposed, then these actions become very symbolic. There are financial operations strategies available that would rely less on the exposure of the target state, and allow US policy executors to actively take advantage of informational asymmetries in several operational contexts. Shubik writes that "Not much material has been written on these topics," and he submits four financial warfare strategies: subverting currencies, destabilizing markets, wrecking credit systems, and breaking financial institutions. [123] This monograph chapter proposes that the national proprietary trading of global derivative financial instruments can be uniquely useful in the conduct of economic statecraft.[124]

Hufbauer considers issues and models regarding the idea of inducing financial crises with sanctions in 1996. He cites US financial pressure on the British Pound Sterling during the Suez crisis in 1956, and Chinese financial pressure on the Taiwanese dollar and stock market during a crisis in 1996 as historical precedence for nations influencing financial markets during crises. Hufbauer details some general macroeconomic indicators of target nation susceptibility to a financial crisis,[125] carefully avoids any recommendation of financial crisis targeting methodology, but then notes that:

> Because the threat of crisis is almost as unnerving to target elites as a crisis itself, this awareness of vulnerability may be enough to achieve the purposes of a sanctions episode. The reason is that officials in the target country will be working in the context of greater uncertainty than the senders. They must respond to financial pressure based upon the mere chance of a crisis. In some circumstances, a mere 20% chance of financial disaster may suffice.[126]

Hufbauer articulates that the appropriateness of such financial "levers" is highly case specific, and always loaded with caveats, including long term damage to the target, "tequila" effects that spill over to other nations, and by implication, the world financial system and economy.[127]

There are many "conventional" opportunities to target and disrupt financial markets and systems in the context of economic warfare. Such opportunities include counterfeiting, attacks on the places, means, and personalities[128] of financial markets, databank and computer sabotage, and destruction of the interstate banking check clearing system. Such actions may in fact be so devastating that a warring state that wants to resume trade with its enemy after conclusion of the conflict may do well to note that "...in the Franco-Prussian War of 1870-1871, Bismarck took great care to keep France's

financial system intact."[129] The US is quite vulnerable to such attacks also, and these attacks could be undertaken through indirect and unconventional means such as mass mailings of incendiary letters and mass emailing of computer viruses. But there are asymmetric areas in financial operations in which the US has powerful inherent advantages.

Induced Inflation

The popular press reported during Operation DESERT SHIELD/DESERT STORM that coalition forces were counterfeiting Iraqi currency (Rials) and physically dumping them over Kuwait and Iraq from helicopters in order to disrupt the Iraqi economy.[130] Shubik relates equally murky tales of Japanese and German contingency plans to counterfeit currency in Russia and China respectively.[131] Such currency dumping, in addition to causing inflation, also lessons the ability of the target government to gain seignorage[132] by their *own* debasement of their nation's currency (i.e., excessive printing of currency). This sort of financial operation amounts to economic warfare to support ongoing military operations, not an economic sanction designed to coerce a target state in an environment short of full scale war.

There are more efficient ways to cause inflation than by dumping currency from helicopters.[133] There are few, if any, autarkies[134] in the increasingly globalized world today, and most countries' currencies are convertible on the open market. Catholic University's James P. O'Leary warns that "...the power to inflict inflation upon adversaries...[is an] important tactic in economic warfare." He cites South African Minister of Labor and Mines S. P. Botha's threat in 1979 to cut off gold production if the US imposed strict economic sanctions against his country over its policy of apartheid.

Resultant gold shortages might then induce global inflation as capital flows move out of paper currencies and into precious metals. Whether or not this would have happened is less relevant that the fact that a small nation was uniquely positioned to threaten global powers with a financial reprisal if they were to undertake an anticipated trade embargo. The US Congress eventually imposed economic sanctions against South Africa over President Reagan's veto, and they proved to be painful but politically ineffective.[135]

An economically strong power, or coalition of powers, could undermine the value of a currency through the national proprietary trading of financial instruments. The result is inflation through currency depreciation - the holders of target nation currency would find that their holdings are worth less in terms of foreign currencies, and imported goods would immediately cost more. This technique also has the merit of weighting its effects upon economic elites who are likely to have a taste for imported goods, as well as the desire to convert their wealth to foreign currency holdings (where it is then vulnerable to an asset seizure action).

The US and other countries have routinely intervened in currency markets[136] since the end of World War II. The goal of such interventions vary: the US and other major powers such as Germany and Japan typically claim that their currency manipulation is necessary to stabilize the world (or regional) trading regimes; many medium sized countries often attempt what is known as competitive devaluations of their currencies to stimulate the domestic economy through exports; many small countries with "fixed" exchange rates often intervene in currency markets to maintain high real exchange rates for domestic political reasons. The execution of proprietary currency intervention as a

financial operation would look less like a conventional currency intervention, and more like the actions of a global hedge fund.

Hedge funds often make huge leveraged bets against currencies that the managers believe will eventually fall anyway. In 1992, George Soros' hedge fund made an $18 billion dollar bet against the British pound sterling and forced it to drop out of the European currency zone. In August of 1997, the combined position against the Hong Kong dollar by a cartel of hedge funds (including Soros's Quantum Fund and Julian Robertson's Tiger Fund) was almost double the stake against Great Britain in 1992, helping to touch off a significant decline in currency values across East Asia.[137] This time, the hedge funds were not as successful as in 1992 though, as Asian currencies recovered and the lines of credit supporting the hedge funds' positions began to dry up.[138] Had the US government backed the "run" on Asian currencies and stock markets, things may have turned out very different.[139]

The US could devalue most nation's currencies using financial instruments and make money doing it.[140] Suppose a medium-sized country engaged in global trade challenged US vital interests. Coordinated action by the Treasury Department to quietly take positions with a variety of derivative instruments (such as buying put options, writing call options, swapping target currency for dollars, and selling target currency futures and forward contracts) against a target state's currency could be effected over a very short period of time (see Glossary and Appendix H (Financial Securities and Derivatives) for definitions and technical background on these financial instruments). Suppose the Treasury then nearly simultaneously shorted (sold currency it had borrowed) the target currency. Currency markets would reflect the pressure on the target state's

currency through a reduced exchange rate, even before markets know that it is the US making the currency attack. Vincent Davis suggested such a scheme might be supported by leaking fake reports from the Federal Reserve Board's Open Market Committee Meetings to cause runs on currencies of small states.[141]

A US led currency attack has fundamental differences with an attack led by a consortium of hedge funds. First, the US has relatively unlimited financial resources. Second, US can exert great influence over possible financial counter-intervention by the World Bank, the International Monetary Fund (IMF), and other friendly powers such as Germany and Japan. Third, the US possesses immense military resources to carry out the physical destruction of a currency's parent state. Fourth, by putting treasure on the line, the US deals with the informational asymmetry of time inconsistency[142] - it is now more visibly committed to a coarse of action that may include the distasteful action of direct armed combat.[143] Costly signals like this are more credible, thus Baldwin asserts that "...costliness is a desired attribute to a policy alternative"[144] James Fearon's 1992 University of California Ph.D. thesis argues that "...costly signals allow people to update their beliefs about others' preferences and intentions in [crisis] situations..."[145]

Sovereign Debt Neutralization

In addition to attacking the currency, the US could also attack the target's sovereign debt. By shorting the target government's bonds, regardless of currency of issue, the US would essentially destroy the target's ability to borrow money anywhere in the world, including domestic financial markets. This action does not rely on risky extraterritorial legal action, but rather on the reaction to information by a global financial market interested only in profit. Sovereign debt neutralization hurts policy elites who

cannot seek financing to resource projects for their political agendas and their constituencies. Furthermore, resultant target state illiquidity immediately denies it the ability to stockpile basic commodities and war stocks necessary to ride out economic sanctions and prepare for military action.

Operation ALLIED FORCE exemplifies the time inconsistent difficulty in obtaining political concessions from political elites involved in war over territorial issues. On April 16, 1999, CNBC news correspondent Charlie Gibson reported that the North Atlantic Treaty Organization (NATO) forces are believed to have begun targeting the factories and other industrial assets belonging to supporters of Serbian President Slobadon Milosevic.[146] On April 22, 1999, NATO forces attacked and destroyed the suburban mansion (and home) of Milosevic, a television station owned by his daughter, and the Milosevic's political party headquarters.[147] In a very unusual move, US Presidential National Security Advisor[148] Sandy Berger said that "The attack is now going on at an unrelenting pace. Increasingly in days to come, targets will include what I call national assets."[149] The Wall Street Journal reported that an unidentified senior administration official added that these fiercer and more personalized bombing attacks is an effort to squeeze Mr. Milosevic, his cronies, and "things that matter to ***him*** [emphasis added]."[150] Perhaps had Milosevic known *before the air campaign started* how "personal" NATO was going to take his rejection of the Rambullet accords, he may have agreed to a NATO peace keeping force in Kosovo.

Pape and the logic of time inconsistency contend that this sort of action reaction game is exactly the problem with economic sanctions (and limited war) when a target regime is engaged in a effort over something that really matters, like territory. If a regime

capitulates after it commits a nation to an important cause, the regime will likely crumble and thus be unable to protect its elite constituency.[151] If the regime holds on and rides out the punishment, then maybe there is a chance to perpetuate itself. Furthermore, target regimes are often bolstered by the "rally around the flag effect" once under economic or military siege.[152] Game theory holds that under conditions of time inconsistency, only a ex-ante credible signal of unrelenting punishment can be effective in deterring an opponent, or changing his behavior before its too late to reconsider. Punishment ex-poste of a target state's rejection of political ultimatums can be useful though in signaling credibility for the next round of a game with the same or another opponent.[153]

Corporate Neutralization

Financial operations can be constructed to deal with time inconsistency through signaling power. One powerful option for US policy makers is to first confront target state political elites by attacking the equity and bond values of stock in which they have stakes. For example, lets say that a target state has publicly and privately held companies in which elites have large management and ownership stakes. Similar to the currency attack, the US Treasury Department begins to take position against the stocks and bonds of these firms using derivative instruments and by shorting them on local and global markets.[154]

The values of these stocks and bonds decline, and the decline becomes a run once markets understand the it is the US taking these positions. Again, factors that are important include vast US financial resources,[155] influence over international economic players and institutions, and the understanding that the US can back up its attack on the

financial instruments by militarily attacking[156] the physical assets to which the stocks and bonds are merely claims.

US forces' technological prowess allows for surgical destruction of elites' factories, plants, and associated distribution centers in order to focus punishment on elites and not the general population. This action could be followed by invoking the Trading with the Enemy Act (TWEA) and attaching US based target firm assets, including trademarks and other intellectual property.[157] In fact, by first attacking the financial claims against these assets, the US now has a financial incentive to complete the military attack, because its financial positions will increase in value. Even more credible, failure to follow through with the attack may result in financial *losses* to Treasury derivative positions, in addition to humiliation in an international crisis.[158] Fearon would call this an "audience cost" of backing down in the crisis, an action that would damage an administration and its party. This credible signal to target state political and economic elites also works to overcome the time inconsistent problem in threatening military action.

Information Profiteering

The US is vulnerable to an informational profiteering operation by any state or group who can obtain an ex-ante informational advantage over financial markets. Before the Iraqi invasion of Kuwait in August of 1990, there is evidence that political and economic elites associated with Iraq's Bathist regime moved billions of dollars of assets into gold, and profited from the rise in the price of gold subsequent to the invasion. Since the Gulf War, there have been allegations that Iraqi government profits from the release of political statements that impact the oil futures markets.[159] Similarly, the profit

opportunity to leverage the ex-ante information of a WMD incident is beyond simple calculation.

Suppose such a group were to invest in the time and resources to be able to initiate detonation or release of a WMD. Such a group could massively profit from the timing and execution of such a WMD attack by using ex-ante knowledge of the attack. The structuring of positions in global financial markets whose value is sure to rise after the attack, offers an arbitrage-like opportunity.[160] Such individuals and groups may align themselves with a state whose political interests would be furthered by the WMD release, but this is not a necessary condition to obtain a WMD, the means to release it, and the ability to profit from its release.[161]

Summary and Conclusion

Global financial markets and derivative financial instruments offer the US the ability to attack the currencies, sovereign debt, and even the corporate securities of a target state. Such attacks help overcome US time inconsistency by placing US treasure at risk. Target states should perceive the credibility of these signals of US resolve to fulfill its coercive intent. As Hufbauer and Elliot state:

> Financial sanctions are more likely [than general economic sanctions] to hit the pet projects or personal pockets of powerful government officials who are in a position to influence policy.[162]

Even if the threat of military action must be carried out, the target state will be economically weaker. Furthermore, much like Nathan Rothschild in the nineteenth century,[163] the US can profit from the destruction of the target sovereign government and domestic corporations, as well as the sale of US based target assets, including intellectual

property. The same logic offers opportunities to select US adversaries, especially in the areas of information profiteering. Finally, US financial operations will gain credibility in future rounds of conflict if the US follows through with the physical destruction of all or portions of a state or other entity targeted by active financial operations.[164]

Chapter 5: Financial Operations and the Practice of Operational Art

"...in the Franco-Prussian War of 1870-1871, Bismarck took great care to keep France's financial system intact."[165] -Peter Druker

For the most part, the study of defense problems [i.e., operational art] is not 'art for art's sake'."[166] - Martin Shubik

The concept of Operational Art arose first in the writings of Soviet military theorists Mikhail Tukechevsky, V. K. Triandafillov, and A. A. Svechin during the interwar period of the 1920s and 30s.[167] Classical military theorists and practitioners Clausewitz, Jomini, and Napoleon do not refer to a concept of Operational Art. According to James J. Schneider of the School of Advanced Military Studies (SAMS) at Fort Leavenworth, KS,

> the term, operational art, arose as a consequence to changes in classical strategy that were brought about through the evolution of warfare. The term was seldom used prior to the nineteenth century. When it was, it referred to the organization of supplies and marches.[168]

Schneider's *Vulcan's Anvil: The American Civil War and the Emergence of Operational Art*, outlines the concept of operational art based upon analysis of the American Civil War. The American Civil War marks a fundamental shift of warfare away from the notion of the climactic decisive battle of annihilation (a la Napoleon), and towards a practice of modern war that is imminently more complex. Armies fought geographically separate but related campaigns dispersed over great areas, time, and purpose. Technological innovation and economic growth both facilitated and propelled this fundamental shift in warfare.[169] Schneider contends that something was very

different about the American Civil War - namely that the belligerents were executing something beyond tactics, but not quite strategy.[170]

Schneider contends that this new phenomena in war is dominated by "distributive maneuver." Characterizing operational art as

> ...the employment of forces in deep distributed operations. These maneuvers consist of deep battles and extended maneuvers punctuated by periods of inaction,[171]

he focuses on what he feels is the dominant characteristic of operational art, distributive maneuver: the dispersion of forces and battles in time, space, and mass. Then is his "The Theory of Operational Art," Schneider compares classical warfare with operational art (see Figure 5-1).[172]

Classical Strategy	**Operational Art**
Maneuver to contact.	Battles and engagements begin immediately at the national borders.
Armies collide in decisive battle.	Several armies fight indecisive battles.
Logistics is a consideration only in initial phases of campaign.	The only decisive battle is the last battle of the war.
Vigorous pursuit after battle.	Logistics considerations impose pauses upon operations often before pursuit can be decisive.
Campaign ends.	Wars consist of several campaigns; campaigns consist of several distinct operations; operations consist of several distinct battles and maneuvers.
Generally war is also terminated.	Operational Art is strategy with the added dimension of depth.
The commander sees the entire battlefield.	The commander sees very little of the many simultaneous battles occurring.

Figure 5-1 (Classical War vs. Operational Art)

Operational art views all of the planning, execution, and sustainment of distributed military efforts holistically. Nonetheless, this holistic effort is manifested through some key attributes:[173]

- **Distributed Operation**: "...an ensemble of deep maneuvers and distributed battles extended in space and time but unified by a common aim. That common aim is the retention or denial of freedom of action"[174]

- **Distributed Campaign**: "...characterized by the integration of several simultaneous and successive distributed operations in a campaign."[175]

- **Continuous Logistics**: "In order for a modern industrial army to maintain a military effective presence, its logistics system must be continuous to supply and move large formations. Without continuous logistics, the movement tempos and the force density would evaporate."[176]

- **Instantaneous Command and Control**: "The operational significance of instantaneous means of communications becomes apparent when one considers the distributed nature of forces deployed in a theater of operations. Unlike classical conditions the distributed deployment of forces creates a greater variety of unexpected or unanticipated tactical and operational possibilities. As a result this variety generates greater information. Since information is the bias of decision, the operational commander is confronted with many more decisions than his classical predecessor. The operational commander thus requires an instantaneous means of communication to adjust his distributed forces in rapid counteraction to the unexpected actions of the enemy."[177]

- **Operationally Durable Formations**: "...capable of conducting indefinitely a succession of distributed operations. The operationally durable formation is the primary engine of operational design: it is the hammer that drives the operational chisel."[178]

- **Operational Vision**: "...a unified and holistic approach in their design, execution and sustainment of campaigns. The gift of operational vision has often been associated with mental agility, the ability to react to incoming information faster than it arrives."[179]

- **Distributed Enemy**: "The enemy must be operationally minded; he must be similarly trained, armed, equipped, structure and commanded as the friendly force. Without this "self-reflection" … tremendous ambiguity

> and confusion ensures because the requisite creative medium does not exist."[180]

Operational art then is the essence of planning and executing military operations linked distributively in time, space, mass, and purpose to achieve strategic aims. Given the widespread and continuous use of economic statecraft to help achieve strategic aims that were once only the province of armies, perhaps the practice of economic statecraft can benefit from some of operational art's constructs. Within economic statecraft, contemporary financial operations have witnessed increase use and innovation that parallels the experience of the field of finance in general. The globalization of the world economy has both impacted, and has been impacted by a revolution in finance.

The Financial Revolution

In the last twenty-five years, scientific discovery led to technological and social change to transform the practice and impact of global finance, just as it transformed armed conflict a hundred years ago during the American Civil War. Academic discovery in the science of finance is highlighted by the Nobel Prize winning effort to solve the mystery of derivative financial instrument pricing: The Black-Scholes option pricing formula. Fischer Black, Myron Scholes, and their associate Merton Miller engendered a revolution in risk management that fueled the exponential growth in the market for financial derivatives. Formerly illegal to trade in some US states (a violation of gambling laws), derivatives are employed by virtually every bank, insurance company, mutual find manager, farmer, and manufacturer in the US, and much of the world. The value of financial swaps used by banks alone exceed $40 trillion dollars.[181] Other trends and

discoveries such as computerization has assisted in the discovery and practice of the science of financial derivatives.

Computerization has changed the concept of money. Most global currencies lost the remaining vestigial ties to gold or other precious metals during the course of the early twentieth century, becoming fiat money.[182] Fiat money has further evolved to become electronic money (E-Money). ATM machines, credit cards, and debit cards are ubiquitous the world over. Each and every day, over one trillion dollars worth of currency is traded electronically in global foreign exchange markets. Many college students with little or no wealth trade stocks from their dorm rooms on "E-Trade" accounts.[183] Emerging financial trends in E-Money and derivative securities are related to changing societal norms relating to finance.

Citizens and organizations of economically developed nations, as well as the world's emerging middle class have embraced the revolution in finance of the last twenty years. US home owners contemplate refinancing of mortgages over cups of coffee in front of their TV.[184] Unlike twenty-five years ago, it is now *uncommon* for personal retirement portfolios to *not* be weighted in risky securities (i.e., stocks) the world over. Interestingly, it is the US that is trailing public retirement privatization reform movement witnessed in Singapore, Chile, and Great Britain.[185] Shareholder activism from mutual funds and pension funds to prod firms' management to act in the shareholder interest is no longer just an American phenomena, it is a becoming a real force in the market for corporate control in Latin America, Asia, and Europe. All of these individual and corporate behaviors point toward fundamental change in global finance.

Distributed Financial Operations

Given the revolution in finance, perhaps it is time for study and development of a theory of distributed financial operations in economic statecraft. Schneider's framework of operational art offers a starting point for the exploration of change in finance and the resulting implications for financial operations. Contemporary US employment of financial operations offer some insight into what could be called modern financial operations. Financial operations should encompass the planning, execution, and sustainment of distributed financial efforts holistically. Through the overarching framework of economic statecraft, modern financial operations are manifested by some key attributes:

- *Distributed Financial Restrictions*: An ensemble of restrictions and distributed adaptive financial engagements extended in scope and time but unified by a common aim. That common aim is the retention or denial of financial freedom of action of states, elites, or non-state actors.

- *Distributed Campaign*: Characterized by the integration of several simultaneous and successive distributed financial operations in a campaign of economic statecraft.

- *Continuous Information*: In order for a modern economic power to maintain economically significant and effective pressure on a target state, its information apparatus must find, analyze, and distribute information on the target state to the various agencies and ad-hoc bodies formed to execute the campaign. Without continuous information, the ability to focus and maintain effective financial pressure on highly adaptive states, elites, and non-state actors.

- *Instantaneous Command and Control of a Distributed Economic Policy Apparatus*: The operational significance of instantaneous means of communications becomes apparent when one considers the distributed nature of agencies activated to execute economic statecraft. Unlike classical economic sanctions, modern financial operations distribute responsibility for gathering information, executing financial restrictions, and coordinating their effectiveness with other elements of national power across many agencies and entities, some of whom are multi-lateral. This creates a greater variety of operational complexity, while expanding the

range of tactical and operational possibilities. As a result this variety generates greater information. Since information is the basis of decision, the operational director is confronted with many more decisions than his classical predecessor. The lead financial operator thus requires an instantaneous (or virtual) means of communication and direction to adjust his distributed restrictions in rapid counteraction to the unexpected actions of the enemy.

- *Informationaly Durable Financial Restrictions*: Modern financial restrictions seek to overcome time inconsistency by credibly signally strength and intentions through the fog of asymmetric information. The informationaly durable financial restriction is one of the primary engines of operational design that sharpen the chisel of economic statecraft.

- *Operational Vision*: Vision provides a unified and holistic approach in the design, execution and sustainment of campaigns of economic statecraft. The gift of operational vision has often been associated with mental agility, the ability to react to incoming information faster than it arrives.

- *Distributed Enemy*: "The enemy must be financially exposed; his economy or financial disposition must be similarly organized and engaged in world commerce. Without this "self-reflection," it is difficult to financially engage target states, elites, and non-state actors.

Studying modern financial operations through the holistic lens of operational provides a framework when contemplating the design of campaigns involving economic statecraft. There are major differences between the classical and modern approaches to economic statecraft (see Figure 5-2). As Shubik and others have written, there is a general absence of academic attention to the science and art of economic statecraft. Perhaps the lens of operational art is a useful starting point for far more serious research and discussion.

Classical Economic Sanctions	**Modern Financial Operations**
Domestic debate before implementation.	Restrictions begin almost immediately at time of crisis start point.
Policies aimed to resolve a discernible issue set.	Multiple policy initiatives focus on multiple goals, some that conflict, others that evolve.
Economic cost of sanctions a consideration prior to implementation.	The only decisive action is the lifting of financial restrictions.
Sanction policies either work or don't work.	Legal considerations impose pauses upon financial operations.
Sanctions have identifiable ends. Generally, war or source of economic conflict is also terminated.	Financial restrictions in an evolving campaign of economic statecraft consist of several distinct operations whose permutations evolve over time.
Sanctions are uni-dimentional.	Financial Operations are economic sanctions with depth and breadth, but also specicivity.
Policy leader sees economic battlefield.	Policy leader sees little of the simultaneous financial restrictions, relying on indirect means to coordinate their interactions.

Figure 5-2 (Classical Economic Sanctions vs. Modern Financial Operations)

CHAPTER 6: Summary, Recommendations, and Conclusion

"...sanctions are blunt instruments that rarely have the intended consequence and more often injure those most victimized by a despot's reign. The question remains, however: What made Mr. Gadhafi give in?"[186] -Wall Street Journal Editorial, April, 1999

"High finance has always been connected with high politics."[187] *-BJ Cohen, Yale University*

Financial operations are an emerging art in economic statecraft. In order to develop this idea, a robust model of economic statecraft was offered that allows economic tactics in conflicts to be analyzed across the full spectrum of inter-state conflict. This model of economic statecraft may not appeal to those who desire to separate "non-forceful" foreign policy tools from those involving force, especially military force. However, such a distinction between forceful and non-forceful policy is artificial and gets in the way of a thorough study of economic statecraft, especially the linkages between various policy tactics, with and without force. This monograph's findings and analysis point toward recommendations for US and multilateral conduct of financial operations in economic statecraft, as well as directions for further investigation.

Summary

Economic Statecraft is all initiatives to influence a target state through manipulation of its economic well-being. The two tactics of economic statecraft are trade restrictions and financial restrictions. These tactics are employed in three forms of economic statecraft that differ in purpose: Economic warfare, economic sanctions, and trade wars. Economic Warfare weakens an adversary's economic potential in order to weaken its military capabilities. Economic sanctions lower the aggregate economic

welfare of a target state by reducing trade in order to coerce the government to change its political behavior. Trade wars threaten or inflict economic harm in order to persuade a target state to agree to terms of trade more favorable to the coercing state. Figure 1-1 (The Complex Interdependence of Economic Statecraft) attempts to capture the utility of this model of economic statecraft in analyzing inter-state (and intra-alliance) conflict with multiple economic lenses.

Historical interpretation and analysis of economic sanctions is often misleading. The following passage by US Military Academy history professors Robert Dougherty and Herald Raugh is typical of historical conclusions about economic sanctions:

> "Historical experience, however, suggests that optimistic assumptions concerning the embargo may not be valid. Most blockades and embargoes have failed to force an opponent to yield, and states establishing an embargo - in an attempt to make it more effective - have been drawn on some occasions toward an undesirable strategy or course of action that otherwise may not have been chosen. To make matters more complicated, the effects of an embargo or the threat of an effective embargo have sometimes triggered acts of desperation from a state that believed it had no alternative."[188]

The controversy over the efficacy of economic sanctions focuses on a false debate over whether sanctions "work," as defined by achieving policy goals against a target state. This discussion misses the reality that economic sanctions fulfill complex signaling roles and have interactions with other forms of economic statecraft and other elements of national power, particularly military force.

Contemporary financial operations benefit from a revolution in global finance. Scientific advances in the theory of finance, the globalization of the world economy, combined with computerization, E-Money, and social change have changed the

conditions under which states execute economic statecraft. US unilateral experience with respect to Chile and Iran, and US/UN multilateral experience with respect to Iraq indicates that financial operations can be particularly effective under certain circumstances. Furthermore, there are opportunities to employ designer sanctions and proprietary trading of financial instruments to overcome agency problems and time inconsistency. Comparison of the evolution in modern financial operations in the twentieth century with the evolution of military operations in the nineteenth century, offer some analytical clues as to how to theoretically approach the study and practice of financial operations in economic statecraft.

Recommendations

"Figure out how to do things so you can get the maximum effect and the least bloodshed."[189] -Sun Tzu, (The Art of War), circa fourth century B.C.

The effort to sharpen coordination of financial operations with other instruments of national power may prove difficult but well worth the energy. Historical analysis indicates that effective distributed financial operations require the personal and active participation of a senior foreign policy leader in the executive branch. The endeavor to provide increased applicability and efficacy of financial operations for the executive branch will require specific steps to carry out three general initiatives to synergize financial operations within economic statecraft and with other elements of national power. The recommendations below serve as a starting point for developing these steps. The goal is not necessarily to use financial *sanctions* more often, but rather to harness the distributive potential of financial *operations* to accomplish foreign policy objectives.

1. Seek to develop and refine financial sanctioning techniques and procedures that focus on target state political and economic elites by:

a. Resourcing detailed academic analysis of historical financial sanctioning events to continue development of a theory of financial operations

b. Tasking appropriate national intelligence activities to execute sufficient "financial preparation of the battlefield"[190] in potential crisis areas to facilitate effective execution of financial operations in an integrated context - this implies a responsive system to continuously update and share information among disparate players in the interagency and potentially multi-lateral process.

2. Research and wargame new approaches to financial operations that may overcome time inconsistency when dealing with adversary states or non-state actors by:

a. Resource and direct applied research in the area of national proprietary trading of financial securities and derivatives.

b. Refine an operational structure to carry out national proprietary trading.

c. Wargame the execution of national proprietary trading in the context of signaling credibility during crises, and shaping the economic environment in future phases of crisis or conflict.

d. Develop legal and other strategies to deter information profiteering by:

(1) Considering enacting laws to deter the release of WMDs for profit that automatically freeze settlements of securities and derivatives trades after release of a WMD.

(2) Counter financial profiteering by sanctioned target states and non-state actors by anticipating, detecting, and punishing such acts.

3. Initiate an interagency discussion on financial operations to improve crisis action coordination by:

a. Building competency in financial operations techniques and procedures by:

(1) Resourcing and encouraging education and training of civilian and military planners and operators in the field of finance, including graduate education, and certifications such as Chartered Financial Analyst (CFA) and Certified Public Accountant (CPA).

(2) Leveraging financial competencies extant in the civilian sector by creating financial operations related skill identifiers or military occupational specialties (MOSs) for enlisted personnel and officers in the reserve component.[191] By implication, the compensation schemes for these financial operations personnel should be commensurate with industry practice, and tied to achievement of operational objectives.

b. Reinforcing existing ad-hoc relationships and practices in the interagency financial operations process (such as working groups and simulations workshops) by:

(1) Establishing some level of written doctrine in this area.

(2) Exercising these relationships through crisis simulations tied in with the wargaming of potential crisis responses or new techniques and procedures of financial operations.

(3) Exchanging formal and informal, periodic and permanent, liaison officers between the major agency players in financial operations such as the State Department Office of Economic Sanctions Policy,[192] OFAC, FINCEN, the Joint Warfare Analysis Center (JWAC), and the planning staffs of the military combatant Commander-in-Chiefs (CINCs).

Conclusion

Economic statecraft is a centerpiece of *The US National Security Strategy*. A major pillar of this strategy is the policy of engagement. New York Times columnist Thomas Friedman explains the justification for US engagement in his book *The Lexus and the Olive Tree* as "...[the] Golden Arches theory of conflict resolution."[193] Reminiscent of the Manchester school of thought from nineteenth century Europe, his belief is that economic integration is a serious restraint on war. While this may be true, it does not follow that we will necessarily have fewer or less costly conflicts in the future. The causes of war (and peace) remain too complex to be explained any single dependent variable, including the level of economic integration. Recent experience in Kosovo suggests that under some circumstances, economic integration and advancement may even facilitate conflict because competing rival groups will gain access to wealth and technology that enables or emboldens them to disrupt the status quo ante.[194]

Practitioners of operational art need to understand that military engagements will be fought in the context of ongoing economic statecraft. Such statecraft will shape future battlefield prior to action, influence the outcome of operational objectives during the fighting, and significantly determine the viability and stability of the strategic end state achieved by military operations. Financial operations are one example of recent

innovations in economic statecraft that offer rich opportunity for campaign synergy at the interagency level. The challenge for military planners is not just to design military constructs in ways that support the framework of economic statecraft, but more significantly, to illicit an ongoing dialog with the various interagency players that are clearly the "main effort" in American foreign policy today.

Glossary

Aid Suspension - The reduction, termination, or slowdown of aid transfers.

ANC - African National Congress.

Arbitrage - Riskless profit.

Autarky - State of economic isolation and self-sufficiency.

BT - Bankers Trust Company.

BENS - Business Executives for National Security.

Blacklist - Ban on doing business with firms that trade with the target country.

Black Night - Large state that interferes with a sanction regime by supporting the target state (i.e., Russia or China during cold war).

Blockade - Naval enforcement of an embargo.

Boycott - Prohibition on imports.

BMI - Bank Markahzi Iran.

BSA - Bank Secrecy Act.

Bundesbank - The Central Bank of Germany.

Byrd Amendment - Congressional legislation that prohibited US enforcement of a UN boycott against apartheid in Rhodesia, despite the fact that the US voted for the boycott in the UN. The amendment was later repealed.

Capital Controls - Restrictions on who can transfer how much capital and for what purposes into or out of a country.

CHIPS - Clearing House Interbank Payment System.

CIA - Central Intelligence Agency.

CFA - Chartered Financial Analyst.

CINC - Commander in Chief.

CJCS - Chairman of the US Joint Chiefs of Staff.

CJTF - Joint Task Force Commander.

COA - Course of Action.

Combined - Pertaining to close military operational or tactical integration of allied military forces.

Competitive Devaluation - Lowering of one's currency exchange rate in order to stimulate the domestic economy through exports.

CPA - Certified Public Accountant.

DA - Department of the Army.

Direct Purchase - Payment for goods or services, e.g., foreign base rights or territorial purchase.

DOD - US Department of Defense.

DRB - Donnelly, Roth, and Baker.[195]

EC - European Commission of the EU; however, before 1 January 1992, the EU was known as the European Community (EC).

Economic Sanctions - To lower the aggregate economic welfare of a target state by reducing trade in order to coerce the government to change its political behavior.

Economic Statecraft - All initiatives to influence a target state through manipulation of its economic well-being. The two tactics of economic statecraft are trade restrictions and financial restrictions.

Economic Warfare - To weaken an adversary's economic potential in order to weaken its military capabilities.

Embargo - Prohibition on exports, sometimes used to refer to a ban on all trade.

Equity - Residual ownership of a firm after obligations to debt holders have been met.

E-Money - Electronic Money.

Ex-Im - Export-Import.

Expropriation - Government seizure of property - often used in the context of situations where developing nations seize property rights of multi-national corporations.

EU - European Union, formerly known as the EC prior to 1 January 1992.

Eurodollars - Any dollar denominated deposit outside of the US; such deposits usually circumvent(ed) FED regulations D and Q.

FAC - Office of Foreign Asset Control, US Department of Treasury.

FATF - Financial Actions Task Force.

FDIC - Federal Deposit and Insurance Corporation.

FED - US Federal Reserve Board.

FEMA - Federal Emergency Management Agency.

FinCEN - Financial Crimes Enforcement Center.

FM - Field Manual.

Forwards - A contract between parties that obligates them to sell or buy a commodity or security (and thus deliver or take delivery of in the future at a specified price on a specified date).

Freezing Assets - Impounding assets, denying access to bank accounts or other financial target assets.

Futures - A contract that obligates parties to sell or buy a commodity or security in the future at a specified price on a specified date through an organized exchange; however, such contracts almost universally end with an offsetting contract in lieu of delivery; additionally, all parties must "mark to market" daily in cash using accounts secured by the exchange. Futures are usually used only for speculation and risk management.

GAO - Government Accounting Office.

GATT - General Agreement on Tariffs and Trade (predecessor of the WTO).

GDP - Gross Domestic Product.

GNP - Gross National Product.

Hedge Fund - An investment fund that takes comparatively risky positions in world financial markets.

HNS - Host Nation Support.

HSE - Hufbauer, Schott, and Elliot; authors of a oft cited study (*Economic Sanctions Reconsidered* of sanctions using a "large N" sanction episode data set.

ICAF - Industrial College of the Armed Forces.

ICERC - Interagency Country Exposure Committee.

ICG - Interagency Coordination Group.

IDB - InterAmerican Development Bank.

IEEPA - International Emergency Economic Powers Act.

IMF - International Monetary Fund.

INSS - Institute for National Security Studies.

IPO - Initial Public Offering.

Joint - Pertaining to close military operational or tactical integration of branches of the armed services (Army, Navy, Air Force, and Marines).

JTF - Joint Task Force.

Junk Bonds - Non-investment grade bonds; these bonds have higher yields due to risk, and are often used to finance hostile takeovers or management led buy-outs of firms.

JWAC - Joint Warfare Analysis Center.

Leverage - Borrowing to take a financial position.

LOGCAP - US Army Logistics Civil Augmentation Program.

Long - Ownership of an asset.

MACOM - Major Command.

MIT - Massachusetts Institute of Technology.

MOS - Military Occupational Specialty

MOU - Memorandum of Understanding.

MPRI - Military Resource Professionals Inc.

NATO - North Atlantic Treaty Organization.

NBFI - Non-Banking Financial Institutions.

NCA - National Command Authority.

OFAC – Office of Foreign Asset Control (see Appendix G).

OMB - Office of Management and Budget.

ONDCP - Office of National Drug Control Policy.

OPEC - Organization of Oil Exporting Countries.

OPMS XXI - US Army Officer Personnel Management System 21.

Options - The right, but not the obligation, to buy or sell an asset, including another security, at a specified "strike" price, prior to a specified expiration date. A **call option** is the option to buy, while a **put option** is an option to sell.

PAM - Pamphlet.

PDF - Panamanian Defense Forces.

PDM - Presidential Decision Memorandum.

Preclusive Buying - Purchase of a commodity in order to deny it to a target country.

Providing Aid - Extension or continuation of aid via bilateral or multilateral channels in the form of loans or grants.

Quarantine - Selective embargo enforced by naval action short of a blockade (e.g., Cuban missile crisis).

Quotas - Quantitative restrictions on particular imports or exports.

Regulation D - US Federal Reserve Board regulation that sets banking reserve requirements in the US.

Regulation Q - US Federal Reserve Board regulation that limited interest on US bank accounts, and prohibited payment of interest on demand deposit accounts in the US (12 CFR para. 217(2)(a)).

Ret. - Retired.

SAAS - US Air Force School of Advanced Airpower Studies

SACEUR - Supreme Allied Commander, Europe.

SAMS - US Army School of Advanced Military Studies.

SASO - Stability and Support Operations.

SEC - Securities and Exchange Commission.

SECDEF - Secretary of Defense.

Security - A financial claim such as a stock or bond.

Short - To sell an asset that one does not own (by borrowing it) in the hope that it falls in value.

Seignorage - Income derived by the state through the money creation process.

SLIC - Savings and Loan Insurance Corporation.

SDT - Specially Designated Terrorist.

Swaps - A contract to swap currencies, cash flows, interest rates, or other financial instruments over time.

Swaptions - An option to conduct a swap.

Tariffs - Taxes on imports; may favor or harm target state.

Taxation - Taxation may favor or harm target state.

Tequila Effect - Financial crisis spill-over.

Time Inconsistency - The phenomena existent when an agent proposes a coarse of action, which will be, on its face, hard to carry out later.

Trade War - To threaten or inflict harm in order to persuade a target state to agree to terms of trade more favorable to the coercing state.

TRADOC - US Army Training and Doctrine Command.

TTP - Tactics, Techniques, and Procedures.

UN - United Nations.

US - United States.

Withholding Dues - Nonpayment, late payment, or reduced payment of financial obligations.

Writing - The action of creating a call or put option in exchange for cash.

WSJ - Wall Street Journal.

WTO - World Trade Organization (successor to GATT).

Appendix A: Hickenlooper Amendment (1962)

APPENDIX II

The Hickenlooper Amendment

§620 (e) of the Foreign Assistance Act of 1961, as amended

(1) The President shall suspend assistance to the government of any country to which assistance is provided under this chapter or any other Act when the government of such country or any government agency or subdivision within such country on or after January 1, 1962--

(A) has nationalized or expropriated or seized ownership or control of property by any United States citizen or by any corporation, partnership, or association not less than 50 per centum beneficially owned by United States citizens, or

(B) has taken steps to repudiate or nullify existing contracts or agreements with any United States citizen or any corporation, partnership, or association not less than 50 per centum beneficially owned by United States citizens, or

(C) has imposed or enforced discriminatory taxes or other exactions, or restrictive maintenance or operational conditions, or has taken other actions, which have the effect of nationalizing, expropriating, or otherwise seizing ownership or control of property so owned,

and such country, government agency, or government subdivision fails within a reasonable time (not more than six months after such action, or, in the event of a referral to the Foreign Claims Settlement Commission of the United States within such period as provided herein, not more than twenty days after the report of the Commission is received) to take appropriate steps, which may include arbitration, to discharge its obligations under international law toward such citizen or entity, including speedy compensation for such property in convertible foreign exchange, equivalent to the full value thereof, as required by international law, or fails to take steps designed to provide relief from such taxes, exactions, or conditions, as the case may be: and such suspension shall continue until the President is satisfied that appropriate steps are being taken, and no other provision of this chapter shall be construed to authorize the President to waive the provisions of this subsection.

Upon request of the President (within seventy days after such action referred to in subparagraphs (A), (B), or (C) of this paragraph, the Foreign Claims Settlement Commission of the United States (established pursuant to Reorganization Plan No. 1 of 1954,

68 Stat. 1279) is hereby authorized to evaluate expropriated property, determining the full value of any property nationalized, expropriated, or seized, or subjected to discriminatory or other actions as aforesaid, for purposes of this subsection and to render an advisory report to the President within ninety days after such request. Unless authorized by the President, the Commission shall not publish its advisory report except to the citizen or entity owning such property. There is hereby authorized to be appropriated such amount, to remain available until expended, as may be necessary from time to time to enable the Commission to carry out expeditiously its functions under this subsection.

(2) Notwithstanding any other provision of law, no court in the United States shall decline on the ground of the federal act of state doctrine to make a determination on the merits giving effect to the principles of international law in a case in which a claim of title or other right is asserted by any party including a foreign state (or a party claiming through such state) based upon (or traced through) a confiscation or other taking after January 1, 1959, by an act of that state in violation of the principles of international law, including the principles of compensation and the other standards set out in this subsection: Provided, that this subparagraph shall not be applicable (1) in any case in which an act of a foreign state is not contrary to international law or with respect to a claim of title or other right acquired pursuant to an irrevocable letter of credit of not more than 180 days duration issued in good faith prior to the time of the confiscation or other taking, or (2) in any case with respect to which the President determines that application of the act of state doctrine is required in that particular case by the foreign policy interests of the United States and a suggestion to this effect is filed on his behalf in that case with the court, or (3) in any case in which the proceedings are commenced after January 1, 1966.

Source: 22 USC §2370(e); similar language also appears in §408(c) of the Sugar Act of 1948, as amended-see 7 USC §1158(c) and P.L. 92-138 of October 14, 1971--which suspends the sugar quotas under cetain conditions

Note: Paragraph (2) of this section is referred to as the Sabattino Amendment. It puts into general law the decision of the Sabattino Case.

APPENDIX B: President Nixon's Statement on Expropriation Policy (JAN '72)

President Nixon issues Policy Statement on Economic Assistance and Investment Security in Developing Nations

Following is a statement by President Nixon issued on January 19, together with excerpts from the transcript of a news conference held in the White House press briefing room that day by Peter G. Peterson, Assistant to the President for International Economic Affairs.

STATEMENT BY PRESIDENT NIXON

White House press release dated January 19

We live in an age that rightly attaches very high importance to economic development. The people of the developing societies in particular see in their own economic development the path to fulfillment of a whole range of national and human aspirations. The United States continues to support wholeheartedly, as we have done for decades, the efforts of those societies to grow economically—out of our deep conviction that, as I said in my inaugural address, "To go forward at all is to go forward together"; that the well-being of mankind is in the final analysis indivisible; and that a better fed, better clothed, healthier, and more literate world will be a more peaceful world as well.

As we enter 1972, therefore, I think it is appropriate to outline my views on some important aspects of overseas development policy. I shall discuss these matters in broader compass and greater detail in messages to be transmitted to the Congress in the coming weeks. Nineteen seventy-one saw great changes in the international monetary and trade fields, especially among the developed nations. A new economic policy was charted for the United States, and a promising beginning was made on a broad reform of the international monetary system—starting with a realignment of international exchange rates. Now, in 1972, the problem of how best to assist the development of the world's emerging nations will move more to the forefront of our concern.

Any policy for such assistance is prompted by a mutuality of interest. Through our development assistance programs, financing in the form of taxes paid by ordinary Americans at all income levels is made available to help people in other nations realize their aspirations. A variety of other mechanisms also serves to transfer economic resources from the United States to developing nations.

Three aspects of U.S. development assistance programs received concentrated attention during the past year. These were:

—Continuing a program of bilateral economic assistance.

—Meeting our international undertakings for the funding of multilateral development institutions.

—Clarifying the role of private foreign investment in overseas development and dealing with the problem of expropriations.

As to our bilateral economic program, it is my intention to seek a regular and adequate fiscal year 1972 appropriation to replace the present interim financing arrangement which expires February 22. I urge that this be one of the first items addressed and completed by the Congress after it reconvenes. Looking beyond this immediate need, I hope the Congress will give early attention to the proposals which I submitted last year to reform our foreign assistance programs to meet the challenges of the seventies.

In regard to our participation in multilateral institutions, I attach the highest importance to meeting in full the financial

pledges we make. In 1970, the United States agreed with its hemispheric partners on replenishing the Inter-American Development Bank. Our contributions to this Bank represent our most concrete form of support for regional development in Latin America. While the Congress did approve partial financing for the Bank before the recess, it is urgent that the integrity of this international agreement be preserved through providing the needed payments in full.

These Inter-American Bank contributions—together with our vital contributions to the International Development Association, the World Bank, and the Asian Development Bank—are the heart of my announced policy of channeling substantial resources for development through these experienced and technically proficient multilateral institutions. These latter contributions also require prompt legislative action, and I look to the Congress to demonstrate to other nations that the United States will continue its long-standing cooperative approach to international development through multilateral financial mechanisms.

I also wish to make clear the approach of this administration to the role of private investment in developing countries and, in particular, to one of the major problems affecting such private investment: upholding accepted principles of international law in the face of expropriations without adequate compensation.

A principal objective of foreign economic assistance programs is to assist developing countries in attracting private investment. A nation's ability to compete for this scarce and vital development ingredient is improved by programs which develop economic infrastructure, increase literacy, and raise health standards. Private investment, as a carrier of technology, of trade opportunities, and of capital itself, in turn becomes a major factor in promoting industrial and agricultural development. Further, a significant flow of private foreign capital stimulates the mobilization and formation of domestic capital within the recipient country.

A sort of symbiosis exists—with government aid efforts not only speeding the flow of, but actually depending for their success upon, private capital, both domestic and foreign. And of course, from the investor's point of view, foreign private investment must either yield financial benefits to him over time or cease to be available. Mutual benefit is thus the *sine qua non* of successful foreign private investment.

Unfortunately for all concerned, these virtually axiomatic views on the beneficial role of and necessary conditions for private capital have been challenged in recent and important instances. U.S. enterprises, and those of many other nations, operating abroad under valid contracts negotiated in good faith, and within the established legal codes of certain foreign countries, have found their contracts revoked and their assets seized with inadequate compensation or with no compensation.

Such actions by other governments are wasteful from a resource standpoint, short-sighted considering their adverse effects on the flow of private investment funds from all sources, and unfair to the legitimate interests of foreign private investors.

The wisdom of any expropriation is questionable, even when adequate compensation is paid. The resources diverted to compensate investments that are already producing employment and taxes often could be used more productively to finance new investment in the domestic economy, particularly in areas of high social priority to which foreign capital does not always flow. Consequently, countries that expropriate often postpone the attainment of their own development goals. Still more unfairly, expropriations in one developing country can and do impair the investment climate in other developing countries.

In light of all this, it seems to me imperative to state to our citizens and to other nations the policy of this government in future situations involving expropriatory acts.

1. Under international law, the United States has a right to expect:

—That any taking of American private property will be nondiscriminatory;

—That it will be for a public purpose; and

—That its citizens will receive prompt, adequate, and effective compensation from the expropriating country.

Thus, when a country expropriates a significant U.S. interest without making reasonable provision for such compensation to U.S. citizens, we will presume that the United States will not extend new bilateral economic benefits to the expropriating country unless and until it is determined that the country is taking reasonable steps to provide adequate compensation or that there are major factors affecting U.S. interests which require continuance of all or part of these benefits.

2. In the face of the expropriatory circumstances just described, we will presume that the United States Government will withhold its support from loans under consideration in multilateral development banks.

3. Humanitarian assistance will, of course, continue to receive special consideration under such circumstances.

4. In order to carry out this policy effectively, I have directed that each potential expropriation case be followed closely. A special interagency group will be established under the Council on International Economic Policy to review such cases and to recommend courses of action for the U.S. Government.

5. The Departments of State, Treasury, and Commerce are increasing their interchange of views with the business community on problems relating to private U.S. investment abroad in order to improve government and business awareness of each other's concerns, actions, and plans. The Department of State has set up a special office to follow expropriation cases in support of the Council on International Economic Policy.

6. Since these issues are of concern to a broad portion of the international community, the U.S. Government will consult with governments of developed and developing countries on expropriation matters to work out effective measures for dealing with these problems on a multilateral basis.

7. Along with other governments, we shall cooperate with the international financial institutions—in particular, the World Bank Group, the Inter-American Development Bank, and the Asian Development Bank—to achieve a mutually beneficial investment atmosphere. The international financial institutions have often assisted in the settlement of investment disputes, and we expect they will continue to do so.

8. One way to make reasonable provision for just compensation in an expropriation dispute is to refer the dispute to international adjudication or arbitration. Firm agreement in advance on dispute settlement procedures is a desirable means of anticipating possible disagreements between host governments and foreign investors. Accordingly, I support the existing International Centre for the Settlement of Investment Disputes within the World Bank Group, as well as the establishment in the very near future of the International Investment Insurance Agency, now under discussion in the World Bank Group. The Overseas Private Investment Corporation will make every effort to incorporate independent dispute settlement procedures in its new insurance and guarantee agreements.

I announce these decisions because I believe there should be no uncertainty regarding U.S. policy. The adoption by the United States Government of this policy is consistent with international law. The policy will be implemented within the framework of existing domestic law until the Congress modifies present statutes along the lines already proposed by this administration. The United States fully respects the sovereign rights of others, but it will not ignore actions prejudicial to the rule of law and legitimate U.S. interest.

Finally, as we look beyond our proper national interests to the larger considerations of the world interest, let us not forget that only within a framework of international law will the developed nations be able to provide increasing support for the aspirations of our less developed neighbors around the world.

Appendix C: Gonzales Amendment (10 MAR '72)

APPENDIX III

The Gonzalez Amendment*

Public Law 92-246,
10 March 1972

Sec. 21. The President shall instruct the United States Executive Director of the [Inter-American Development] Bank to vote against any loan or other utilization of the funds of the Bank for the benefit of any country which has--

(1) nationalized or expropriated or seized ownership or control of property owned by any United States citizen or by any corporation, partnership, or association not less than 50 per centum of which is beneficially owned by United States citizens;

(2) taken steps to repudiate or nullify existing contracts or agreements with any United States citizen or any corporation, partnership, or association not less than 50 per centum of which is beneficially owned by United States citizens; or

(3) imposed or enforced discriminatory taxes or other exactions, or restrictive maintenance or operational conditions, or has taken other actions which have the effect of nationalizing expropriating, or otherwise seizing ownership or control of property so owned;

unless the President determines the (A) an arrangement for prompt, adequate, and effective compensation has been made, (B) the parties have submitted the dispute to arbitration under the rules of the Convention for the Settlement of Investment Disputes, or (C) good faith negotiations are in progress aimed at providing prompt, adequate, and effective compensation under the applicable principles of international law.

*An amendment to the Inter-American Development Bank Act.

Source: House Committee on Foreign Affairs, Inter-American Relations, US Government Printing Office, Washington, DC: 1972, pp. 106-7.

Appendix D: Executive Order 12170 (Blocking Iranian Government Property)

EXECUTIVE ORDERS

No. 12170

November 14, 1979, 44 F.R. 65729

BLOCKING IRANIAN GOVERNMENT PROPERTY

Pursuant to the authority vested in me as President by the *Constitution* and laws of the United States including the International Emergency Economic Powers Act, 50 U.S.C.A. sec. 1701 et seq., the National Emergencies Act, 50 U.S.C. sec. 1601 et seq., and 3 U.S.C. sec. 301.

I, JIMMY CARTER, President of the United States, find that the situation in Iran constitutes an unusual and extraordinary threat to the national security, foreign policy and economy of the United States and hereby declare a national emergency to deal with that threat.

I hereby order blocked all property and interests in property of the Government of Iran, its instrumentalities and controlled entities and the Central Bank of Iran which are or become subject to the jurisdiction of the United States or which are in or come within the possession or control of persons subject to the jurisdiction of the United States.

The Secretary of the Treasury is authorized to employ all powers granted to me by the International Emergency Economic Powers Act to carry out the provisions of this order.

This order is effective immediately and shall be transmitted to the Congress and published in the **Federal Register**.

JIMMY CARTER

THE WHITE HOUSE,
November 14, 1979.

Appendix E: Executive Order 12872 (Blocking Property of Persons Obstructing Democratization in Haiti)

Monday, October 25, 1993

Volume 29--Number 42
Pages 2089-2154

Week Ending Friday, October 22, 1993

Executive Order **12872**--Blocking Property of Persons Obstructing Democratization in Haiti

October 18, 1993

By the authority vested in me as President by the Constitution and the laws of the United States of America, including the International Emergency Economic Powers Act (50 U.S.C. 1701 et seq.), the National Emergencies Act (50 U.S.C. 1601 et seq.), and section 301 of title 3, United States Code, and in order to take additional steps with respect to the grave events that have occurred in the Republic of Haiti to disrupt the legitimate exercise of power by the democratically elected government of that country and with respect to the national emergency described and declared in Executive Order No. 12775,

I, William J. Clinton, President of the United States of America, hereby order:

Section 1. Except to the extent provided in regulations, orders, directives, or licenses, which may hereafter be issued pursuant to this order, and notwithstanding the existence of any rights or obligations conferred or imposed by any international agreement or any contract entered into or any license or permit granted before the effective date of this order, all property and interests in property of persons:

(a) Who have contributed to the obstruction of the implementation of the United Nations Security Council Resolutions 841 and 873, the Governors Island Agreement of July 3, 1993, or the activities of the United Nations Mission in Haiti;

(b) Who have perpetuated or contributed to the violence in Haiti; or

(c) Who have materially or financially supported any of the foregoing, that are in the United States, that hereafter come within the United States, or that are or hereafter come within the possession or control of United States persons, including their overseas branches, are blocked.

Sec. 2. Any transaction subject to U.S. jurisdiction that evades or avoids, or has the purpose of evading or avoiding, or attempts to violate, any of the prohibitions set forth in this order, or in Executive Orders Nos. 12775, 12779, or 12853, is prohibited, notwithstanding the existence of any rights or obligations conferred or imposed by any international agreement or any contract entered into or any license or permit granted before the effective date of this order, except to the extent provided in regulations, orders, directives, or licenses issued pursuant to the relevant Executive order and in effect on the effective date of this order.

Sec. 3. The Secretary of the Treasury, in consultation with the Secretary of State, is hereby authorized to take such actions, including the promulgation of rules and regulations, and to employ all powers granted to me by the International Emergency Economic Powers Act, as may be necessary to carry out the purpose of this order. The Secretary of the Treasury may redelegate any of these functions to other officers and

agencies of the United States Government, all agencies of which are hereby directed to take all appropriate measures within their authority to carry out the provisions of this order, including suspension or termination of licenses or other authorizations in effect as of the date of this order.

Sec. 4. Nothing contained in this order shall create any right or benefit, substantive or procedural, enforceable by any party against the United States, its agencies or instrumentalities, its officers or employees, or any other person.

Sec. 5. (a) This order shall take effect at 11:59 p.m., eastern daylight time on October 18, 1993.

(b) This order shall be transmitted to the Congress and published in the Federal Register.

William J. Clinton

The White House,
October 18, 1993.

[Filed with the Office of the Federal Register, 4:26 p.m., October 18, 1993]

Note: This Executive order was published in the Federal Register on October 20.

Appendix F: Executive Order 12978 (Blocking Assets and Prohibiting Transactions With Significant Narcotics Traffickers)

Executive Order 12978—Blocking Assets and Prohibiting Transactions With Significant Narcotics Traffickers

October 21, 1995

By the authority vested in me as President by the Constitution and the laws of the United States of America, including the International Emergency Economic Powers Act (50 U.S.C. 1701 *et seq.*) (IEEPA), the National Emergencies Act (50 U.S.C. 1601 *et seq.*), and section 301 of title 3, United States Code.

I, William J. Clinton, President of the United States of America, find that the actions of significant foreign narcotics traffickers centered in Colombia, and the unparalleled violence, corruption, and harm that they cause in the United States and abroad, constitute an unusual and extraordinary threat to the national security, foreign policy, and economy of the United States, and hereby declare a national emergency to deal with that threat.

Section 1. Except to the extent provided in section 203(b) of IEEPA (50 U.S.C. 1702(b)) and in regulations, orders, directives, or licenses that may be issued pursuant to this order, and notwithstanding any contract entered into or any license or permit granted prior to the effective date, I hereby order blocked all property and interests in property that are or hereafter come within the United States, or that are or hereafter come within the possession or control of United States persons, of:

(a) the foreign persons listed in the Annex to this order;

(b) foreign persons determined by the Secretary of the Treasury, in consultation with the Attorney General and the Secretary of State:

(i) to play a significant role in international narcotics trafficking centered in Colombia; or

(ii) materially to assist in, or provide financial or technological support for or goods or services in support of, the narcotics trafficking activities of persons designated in or pursuant to this order; and

(c) persons determined by the Secretary of the Treasury, in consultation with the Attorney General and the Secretary of State, to be owned or controlled by, or to act for or on behalf of, persons designated in or pursuant to this order.

Sec. 2. Further, except to the extent provided in section 203(b) of IEEPA and in regulations, orders, directives, or licenses that may be issued pursuant to this order, and notwithstanding any contract entered into or any license or permit granted prior to the effective date, I hereby prohibit the following:

(a) any transaction or dealing by United States persons or within the United States in property or interests in property of the persons designated in or pursuant to this order;

(b) any transaction by any United States person or within the United States that evades or avoids, or has the purpose of evading or avoiding, or attempts to violate, any of the prohibitions set forth in this order.

Sec. 3. For the purposes of this order:

(a) the term "person" means an individual or entity;

(b) the term "entity" means a partnership, association, corporation, or other organization, group or subgroup;

(c) the term "United States person" means any United States citizen or national, permanent resident alien, entity organized under the laws of the United States (including foreign branches), or any person in the United States;

(d) the term "foreign person" means any citizen or national of a foreign state (including any such individual who is also a citizen or national of the United States) or any entity not organized solely under the laws of the United States, or existing solely in the United States, but does not include a foreign state; and

(e) the term "narcotics trafficking" means any activity undertaken illicitly to cultivate, produce, manufacture, distribute, sell, finance or transport, or otherwise assist, abet, conspire, or collude with others in illicit activities relating to, narcotic drugs, including but not limited to, cocaine.

Sec. 4. The Secretary of the Treasury, in consultation with the Attorney General and the Secretary of State, is hereby authorized to take such actions, including the promulgation of rules and regulations, and to employ all powers granted to the President by IEEPA as may be necessary to carry out this order. The Secretary of the Treasury may redelegate any of these functions to other officers and agencies of the United States Government. All agencies of the United States Government are hereby directed to take all appropriate measures within their authority to carry out this order.

Sec. 5. Nothing contained in this order shall create any right or benefit, substantive or procedural, enforceable by any party against the United States, its agencies or in-

mentalities, its officers or employee
other person.

Sec. 6. (a) This order is effective at
a.m. Eastern Daylight Time on Octob
1995.

(b) This order shall be transmitted
Congress and published in the *Federa*
ster.

William J. Clin

The White House,
October 21, 1995.

Filed with the Office of the Federal R
11:21 a.m., October 23, 1995]

NOTE: This Executive order was release
Office of the Press Secretary on Octobe
It was published with its annex in the *Fed*
ster on October 24.

Appendix G (Office of Foreign Asset Control (OFAC) Web Page)

Office of Foreign Assets Control

MISSION:

The Office of Foreign Assets Control of the U.S. Department of the Treasury administers and enforces economic and trade sanctions against targeted foreign countries, terrorism sponsoring organizations and international narcotics traffickers based on U.S. foreign policy and national security goals. OFAC acts under Presidential wartime and national emergency powers, as well as authority granted by specific legislation, to impose controls on transactions and freeze foreign assets under U.S. jurisdiction. Many of the sanctions are based on United Nations and other international mandates, are multilateral in scope, and involve close cooperation with allied governments.

Go to text only page

Please be Aware that New Information is Available as of 02-23-99.

An overview of O.F.A.C. Regulations involving Sanctions against Iran in *.PDF format.

An overview of the Iraqi Sanctions Regulations in *.PDF format.

An overview of the Libyan Sanctions Regulations in *.PDF format.

A summary of U.S. Sanctions involving the Federal Republic of Yugoslavia (including the Executive Order relating to Kosovo) in *.PDF format.

An overview of the Cuban Assets Control Regulations in *.PDF format.

An overview of the Foreign Assets Control Regulations as they relate to North Korea in *.PDF format.

A summary of the UNITA (Angola) Sanctions Regulations in *.PDF format.

A summary of the Terrorism Sanctions Regulations, the Terrorism List Governments Sanctions Regulations (Syria) and the Foreign Terrorist Organizations Sanctions Regulations in *.PDF format.

A summary of sanctions against international Narcotics Traffickers in *.PDF format.

A summary of sanctions against Burma (Myanmar) in *.PDF format

A summary of sanctions against Sudan in *.PDF format.

A summary of the Weapons of Mass Destruction Trade Control Regulations in *.PDF format.

FOREIGN ASSETS CONTROL REGULATIONS

For Bankst1 1facei.pdft1 1facei.pdf For Exporters & Importerst1 1facsc.pdft1 1facsc.pdf For Securities Industryt1 1facin.pdft1 1facin.pdf For Insurance Industry t1 1trav.pdfFor Tourism Industry

SPECIAL INFORMATION ON DESIGNATED NATIONALS AND BLOCKED PERSONS

(SDN list last updated on 08-21-98)

Alphabetical Master list of Specially Designated Nationals and Blocked Persons in *.PDF format

Recent changes to Master list of Specially Designated Nationals and Blocked Persons in *.PDF format

DOS, delimited, and fixed-field versions of Master list of Specially Designated Nationals & Blocked Persons for downloading in ASCII *.exe file.

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Unified Procedures Regulations involving Reporting, License Applications, etc.

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U.S. Department of Commerce Bureau of Export Administration and its List of Denied Parties.

Please give us your general comments on Foreign Assets Control's web pages.

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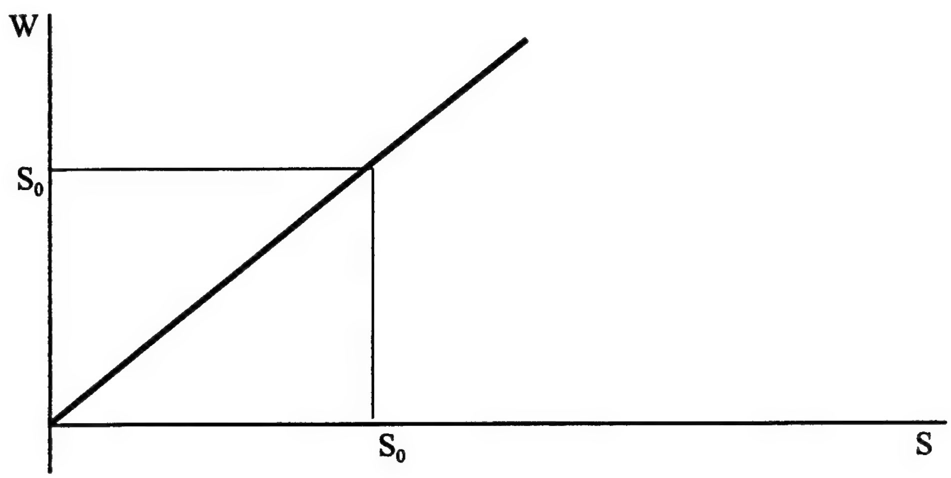
Last Updated on February 23, 1999

Appendix H: Financial Securities and Derivatives

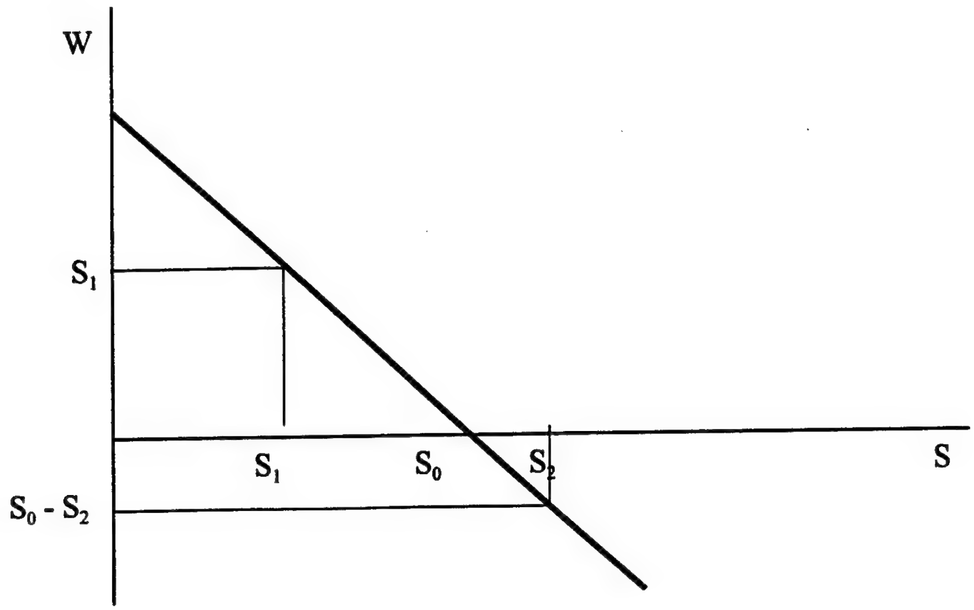
This Appendix provides some technical detail to the subject of financial securities and derivatives. Investment banks often hire mathematicians and physicists to deal with the mathematical complexity of financial engineering, and they pay million dollar bonuses to their best performing traders and deal makers. Leading areas for research in financial engineering include computer simulation, chaos theory, and use of expert systems. Definitions of the financial instruments listed below are in the Glossary. For a more detailed reference on financial securities and derivatives, see Brealey and Meyers, *Principles of Corporate Finance*, 5th Edition, (New York, NY: McGraw Hill Companies, Inc., 1996); Hull, John C., *Options, Futures, and other Derivative Securities* (2d Edition), (Englewood Cliffs, NJ: Prentice Hall, 1993); and Cox, John C., and Rubinstein, Mark, *Options Markets*, (Englewood Cliffs, NJ: Prentiss Hall, Inc., 1985).

1. **Long Positions**: A long position in a stock, bond, or other security denotes ownership. The owner benefits if the price of the asset rises, and loses wealth if the asset price falls. See the payoff diagram below:

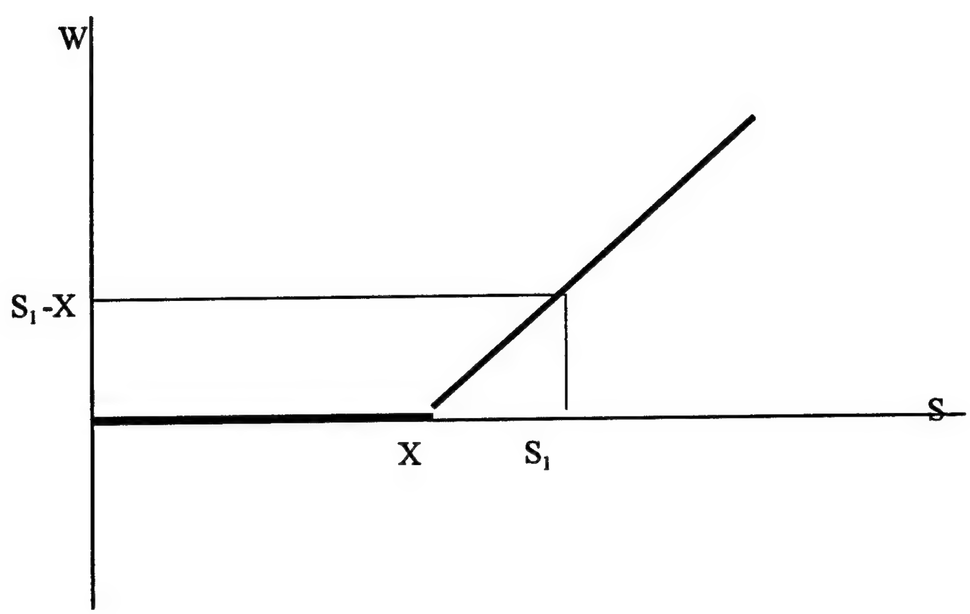


W = Wealth
S = Share (or asset) Price
S_t = Share Value at Time t

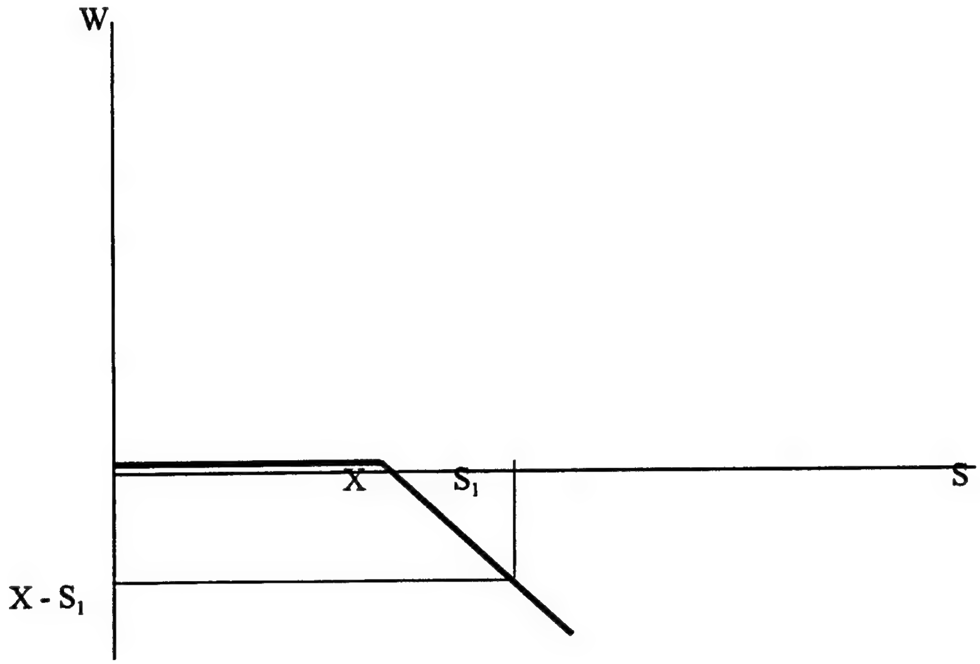
2. **Short Position**: A short position in a stock, bond, or other security denotes that the security has been borrowed and sold (at price S_0). The position holder benefits if the price of the asset falls, and loses wealth if the asset price rises. See the payoff diagram below



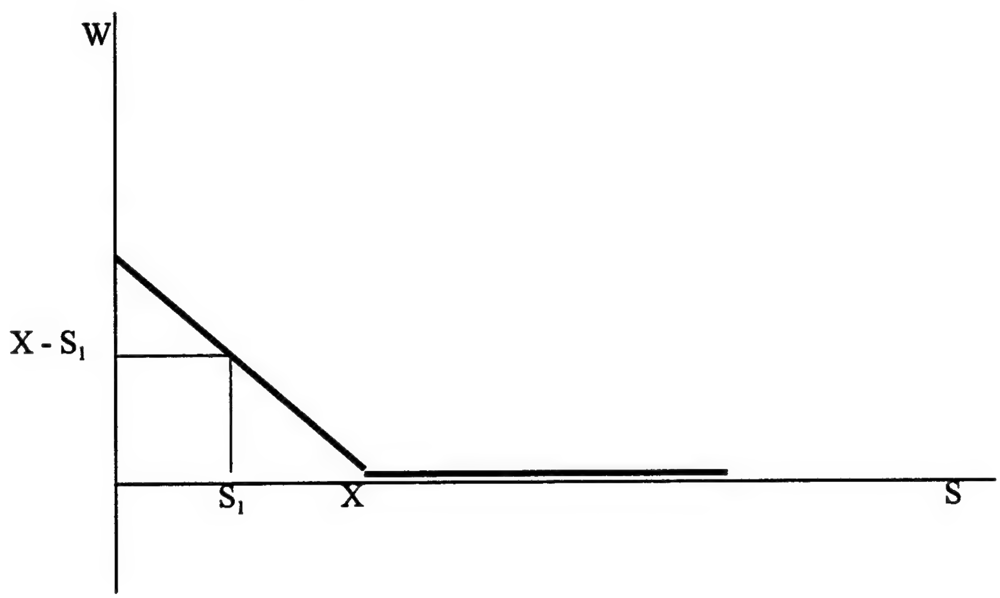
3. **Long Call Option**: At expiration, a call option is worth the greater of the difference of the underlying asset value and the strike price, or zero.



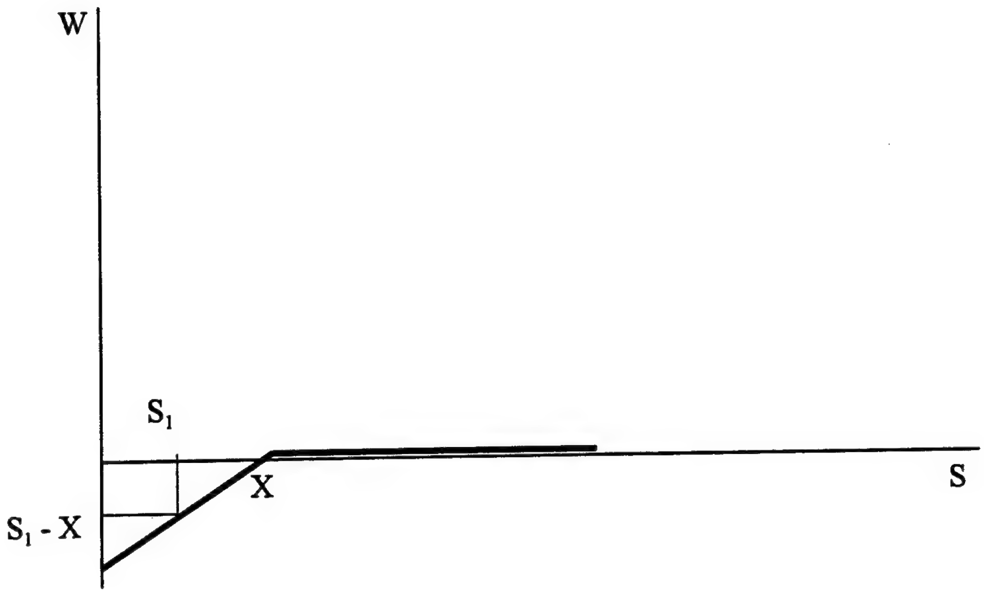
4. **Written Call Option**: At expiration, a written call option is worth the lesser of the difference of the underlying strike price and the asset value, or zero.



5. **Long Put Option**: At expiration, a put option is the greater of difference of the strike price and the underlying asset value, or zero.



6. **Written Put Option**: At expiration, a written put option is worth the lesser of the difference of the underlying asset value and the strike price, or zero.



7. **Determinants of Option Value:** The value of holding *any* option before expiration will be *more* than indicated by the payoff diagram. This extra value is known as "time value" or "option value." Conversely, the value of holding a written position in any option will be the *opposite* of holding the long position. The market price of an option is called its premium - this is its value. There are five factors that determine option value (see Figure G-1 below). The arrows indicate the direction of change of the value of the option given an *increase* in the value of the determinant.:

Determinant	Call	Put
Current Underlying Asset Price (S)	|	|
Strike Price (X)	|	|
Time to Expiration (t)	|	|
Asset Volatility (σ)	|	|
Interest Rates (r)	|	|
Cash Income (DIV)	|	|

Figure H-1 (Determinants of Option Value)

8. **Black-Scholes Option Pricing Formula**[196]: The Black-Scholes Option Pricing Formula is a closed form method of calculating the value of an option.

a. **Call Option**: $C = SN(d_1) - Xe^{-rt}N(d_2)$

Where,

C	= value of call
d_1	$= (\ln(S/X) + rt + \sigma^2 t/2)/\sigma t^{1/2}$
d_2	$= (\ln(S/X) + rt - \sigma^2 t/2)/\sigma t^{1/2}$
$N(d)$	= cumulative normal probability density function
X	= exercise price
t	= time to exercise date
S	= price of asset now
σ^2	= variance per period of (continuously compounded) rate of return on the asset
r	= continuously compounded risk free rate of interest

b. **Put Option**: $P = Xe^{-rt}N(-d_2) - SN(-d_1)$

Where, P = value of put

9. **European Put-Call Parity**: $C + PV(X) = P + S$

Where, PV = present value

10. **Futures:** The future value of a commodity can be found by:

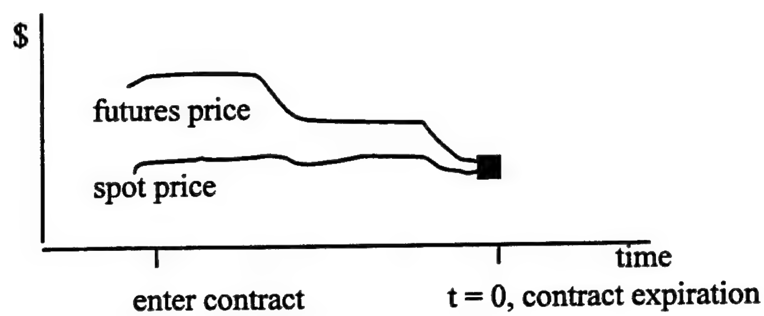
$$F = S(1 + r) + PV(\text{storage costs}) - PV(\text{convenience yield})$$

Where, F = value of the future

And for any commodity with no storage costs or convenience yield such as currency,

$$F = S(1 + r)$$

No cash exchanges hands between the short and long position holders in a futures contract exchange. Each day, futures positions are "marked to market" by the exchange - that is, cash is transferred between position holders as the futures price moves. At expiration, the future price (F) equals the spot price (S). See below:



11. **Swaps and Swaptions:** Like futures, contractual parties to swaps and swaptions enter the agreement with no initial cash consideration. During each period of the contract, the parties must/may execute the swap/swaption respectively. For example, in an interest rate swap, one party may pay a fixed rate of interest on some notional principle amount to another party, who is then responsible to pay the other party a variable rate of interest. Calculating the value of a swap position during the course of the contract is contract specific by nature.

Endnotes

[1] Martin Shubik, and J. Hoult Verkerke, "Open Questions in Economic Warfare," *Journal of Conflict Resolution*, (London, England: Sage Publications, Volume 33, Number 3, September, 1989), 97.

[2] Bob Davis, "Policy makers debate How to Handle the next Kosovo," *The Wall Street Journal*, (New York, NY: Dow Jones and Company, April 30, 1999), A16.

[3] Ibid.

[4] Richard J. Ellings, *Embargoes and World Power: Lessons from American Foreign Policy*, (Boulder, CO: Westview Press, 1985), 17-18. Baldwin presents an alternative to this causal relationship - that war with Sparta was coming anyway, and sanctioning Megara was a prudent Athenian option short of war to signal strength against its many potential foes in the region. See David A. Baldwin, *Economic Statecraft*, (Princeton, NJ: Princeton University Press, 1985), 154.

[5] Ibid, 115.

[6] Centers of gravity is a US Army and joint doctrinal term that refers to the "hub of all power and movement," as described in Carl von Clauswitz' nineteenth century book on military theory, *On War*.

[7] Martin Shubik, "Unconventional Methods of Economic Warfare," *Conflict*, (Crane, Russak & Company, Inc., Volume 1, Number 3, 1979), 212.

[8] A term used for late twentieth century economic, social, and technological integration of the world community that greatly impacts business and world politics.

[9] Robert A. Pape, "Why Economic Sanctions Do Not Work," *International Security*, (Cambridge, MA: Harvard University and the Massachusetts Institute of Technology, Fall, 1997),93.

[10] Gary C. Hufbauer, *Financial Sanctions: The Nature of the Tool and Preliminary Recommendations*, (Washington, DC: Institute for International Economics, January 11, 1996), 6.

[11] Sharfen, J. R. *The Helms-Burton Act: A Strategic Critique*. Carlisle Barracks, PA: US Army War College, March 31, 1998.

[12] Doran, George T. *The Futility of Economic Sanctions as an Instrument of National Power in the 21st Century*. Carlisle Barracks, PA: US Army War College, March 1, 1998.

[13] Robert A. Pape, "Why Economic Sanctions Do Not Work," *International Security*, (Cambridge, MA: Harvard University and the Massachusetts Institute of Technology, Fall, 1997), 106. Pape argues that "...the key reason that sanctions fail is that modern states are not fragile." See also Pape's book *Bombing to Win*.

[14] Donald G. Boudreau, "Economic Sanctions and Military Force in the Twenty First Century," *European Security*, (London, England: Frank Cass, Volume 6, Number 2, Summer, 1997), 38. Boudreau is referring to views of Henry Bienen and Robert Gilpin.

[15] Richard N. Haass, "Sanctioning Madness," *Foreign Affairs*, (New York, NY: Council on Foreign Relations, November/December, 1997), 7.

[16] Donald G. Boudreau, "Economic Sanctions and Military Force in the Twenty First Century," *European Security*, (London, England: Frank Cass, Volume 6, Number 2, Summer, 1997), 41.

[17] John C. Sharfen, *The Dismal Battlefield*, (Annapolis, MD: Naval Institute Press, 1995), 91.

[18] John Mueller, and Karl Mueller, "Sanctions of Destruction," *Foreign Affairs*, (New York, NY: Council on Foreign Relations, Volume 78, Number 3, May/June, 1999), 50-51. The Muellers' assert that by 1998, UN economic sanctions resulted in additional 90,000 deaths per year in Iraq, 40,000 of them children under 5 years of age. They also contend that the sanctions will not achieve UN counter WMD objectives. They calculate total historical WMD deaths at less than 400,000 by including all uses of nuclear, chemical, and biological weapons.

[19] J. Moran, "Oh, Stop! Please! These UN Sanctions Are Killing Me! Ouch!," *The Miami Herald*, (Miami, FL: Knight Ridder, Distributed by King Features Syndicate, December 17, 1993.)

[20] Bechtel, Peter. (Executive Officer to the Director, Office of National Drug Control Policy). Washington, DC: Interview, March 7, 1999.

[21] The Army's FM 100-5 (Operations) further defines the term "operation art" as: "The employment of military forces to attain strategic goals through the design, organization, integration, and execution of battles and engagements into campaigns and major operations. In war, operational art determines when, where, and for what purpose major forces will fight over time."

[22] The US Army uses the term "TTP" to mean tactics, techniques, and procedures. Military TTPs are found in the lowest level field manuals (FMs), while military doctrine is found in higher level FMs.

[23] A derivative is a security whose price depends on the value of another asset or security, and other factors.

[24] John C. Sharfen, *The Dismal Battlefield*, (Annapolis, MD: Naval Institute Press, 1995), 9.

[25] John C. Sharfen, *The Dismal Battlefield*, (Annapolis, MD: Naval Institute Press, 1995), 74.

[26] ABC News. "Sanctions' Big Talk, Little Stick: Are Sanctions Helping the Correct People," *Nightline*, (Washington, DC: Federal Document Clearing House, Transcript of ABC Nightline with Ted Koppel, August 6, 1998).

[27] Ibid. John Donovan of ABC news made this claim.

[28] James C. Ngobi, "The United Nations Experience with Sanctions, *Economic Sanctions* (Lopez, George A., and Cortrite, David (Editors)), (Boulder, CO: Westview Press, 1995), 17.

[29] Elizabeth S. Rogers, "Using Economic Sanctions to Control Regional Conflicts, " *Security Studies*, (London, England: Frank Cass, Summer, 1996), 55. Rogers states that the average annual rate of new US sanction measures is 2.5 per year for the 1980s, and 3 times per year from 1990-1996.

[30] Richard N. Haass, "Sanctioning Madness," *Foreign Affairs*, (New York, NY: Council on Foreign Relations, November/December, 1997), 1.

[31] Nineteenth century Prussian War Theorist Carl von Clauswitz (*On War*) inductively concluded that the defense, not the offense, must be the stronger form of war, since weaker states normally chose to defend.

[32] Robert A. Pape, "Why Economic Sanctions Do Not Work," *International Security*, (Cambridge, MA: Harvard University and the Massachusetts Institute of Technology, Fall, 1997), 109.

[33] David A. Baldwin, *Economic Statecraft*, (Princeton, NJ: Princeton University Press, 1985), 13-14.

[34] Ibid, 30.

[35] Baldwin acknowledges that many analysts use this sort of definition for economic statecraft, however, for his purposes, he chose a more narrow definition. Baldwin (David A. Baldwin, *Economic Statecraft*, (Princeton, NJ: Princeton University Press, 1985), 36) feels the issue is between "means (his narrow definition), or effects (the general definition that, for example, accepts naval blockades and even bombing of industrial targets as economic statecraft). Note: This monograph uses the more general definition of economic statecraft, and then breaks this into three *forms* by purpose in order to analyze a wider scope of interagency issues in terms of operational art. For example, if the purpose of an embargo is to affect the military capability of another nation, then this is economic warfare. Likewise, if the purpose of bombing a target state is to lower GDP until the target decides to meet sender demands, then this is a sanction.

[36] Robert A. Pape, "Why Economic Sanctions Do Not Work," *International Security*, (Cambridge, MA: Harvard University and the Massachusetts Institute of Technology, Fall, 1997), 94.

[37] Ibid. 94.

[38] Ibid, 93. Note that this definition drops Pape's word "international" before the word trade, allowing any action that affects internal or external trade to be considered a "sanction" if the intent is to achieve a goal by changing economic well being.

[39] Ibid. See glossary for definitions. This monograph defines restrictions as any effort to interfere with or stop external or internal trade or financial services. This definition is more expansive than that provided by Pape.

[40] An additional methodology through which to categorize economic tactics has been by purpose and form, i.e., attack vs. defense, and conventional versus unconventional. See Martin Shubik, "Unconventional Methods of Economic Warfare," *Conflict*, (Crane, Russak & Company, Inc., Volume 1, Number 3, 1979), 213.

[41] David A. Baldwin, *Generic Sanctioning Methodology: An Analytical Framework*, (Washington, DC: Unpublished Manuscript, December 21, 1997). US policy goal sets include promoting human rights (South Africa, China, Rhodesia), discouraging nuclear weaponry (North Korea, Pakistan), discouraging unfair trade practices (Japan, Brazil), discouraging drug trafficking (Bolivia, Columbia), encouraging hostage release (Iraq, Iran), promoting economic development (aid to poor countries), containing communism (Soviet Union, WARSAW Pact, China), destabilizing regimes (Castro's Cuba), strengthening regimes (Marshall Plan in Western Europe), stopping wars (Suez Crisis in 1956), preparing for war (Japan, 1941), fighting wars (World Wars I and II), promoting recovery from war (aid to Japan and Western Europe after World War II),

strengthening alliances (NATO), weakening alliances (WARSAW Pact), promoting democracy (South Africa, Haiti), punishing terrorism (Libya).

[42] US News and World Report, ("At Brink of Trade War, Japan Backs Away," *US News and World Report*), (New York, NY: US News and World Report Inc., December 12, 1977).

[43] Bhushan Bahree, "WTO Says US Can Apply EU Import Tariffs," *The Wall Street Journal*, (New York, NY: Dow Jones & Company, April 20, 1999), A18.

[44] Ibid.

[45] Julie Wolf and Scott Kilman, "EC Prepares to Block Imports of Beef From US That It Doesn't Already Ban," *The Wall Street Journal*, (New York, NY: Dow Jones & Company, April 22, 1999), A4.

[46] Tom Clancy, *Debt of Honor*, (Berkeley, CA: The Berkeley Publishing Group, 1994). In *Debt of Honor*, Japan attacks US forces in the Pacific in response to US trade related actions in an attempt to regain the East Asian CO-Prosperity Sphere (also known as the New Order in East Asia) lost in World War II. Clancy's novel illustrates a hypothetical simultaneous operation where the Japanese physically attack the US Navy in the Pacific, dump US government bonds in a massive selling spree, and execute an ingenious informational attack on US equity markets through the use of a computer virus to induce the appearance of massive program short-selling (large scale computerized trades betting on a falling market), and ends with the wiping out of electronic trading records for the day. Japan then sues for peace while playing an "India card" alliance to deter American resolve.

[47] Strategic bombing of industrial or other economic targets meets the definition of economic warfare as a disruption of internal target country trade.

[48] This will be argued later in the monograph with respect to financial operations (i.e., that in a wartime scenario, they have utility beyond their role as tools of economic warfare and can accomplish political objectives unreachable even by force).

[49] Robert A. Pape, "Why Economic Sanctions Do Not Work," *International Security*, (Cambridge, MA: Harvard University and the Massachusetts Institute of Technology, Fall, 1997), 97. This line of reasoning follows through with much of Pape's criticism of sanctions - that is, how can a target state be expected to yield to economic pressure over issues (like territory) that are important enough reasons to fight a war. Modern states are resilient, as shown by the ability of states like Germany, Japan, Vietnam, and even Serbia to ride out direct US and allied attacks on its economic infrastructure and still re-route resources and establish "work arounds" to continue the war effort. On 30 April, the New York Times reported that Operation ALLIED FORCE air attacks had cut Yugoslavian gross domestic product in half, and this halving of economic output is on top of a halving of output that occurred between 1992 and 1997 through the application of international economic sanctions. The oil industry, a profitable part of the economy and a prime candidate for early privatization, has been almost completely devastated, with the two refineries in Yugoslavia and most of their storage tanks destroyed. The five-week air campaign, intended to change President Slobodan Milosevic's policies toward the southern Serbian province of Kosovo, is also destroying the country's civilian industrial capacity and public works, including its highway, rail and

communications networks. The air war has halved economic output and thrown more than 100,000 people out of work, Western-trained and independent economists said. Although it is difficult to estimate the cost of replacements and repairs if the war stopped today, the economists said, the damage has had greater effects on the gross domestic product than the Nazi and then the Allied bombing of Yugoslavia, which was a much more rural country during World War II." See Steven Erlanger, "Economists Find Bombing Cuts Yugoslavia's Production in Half," *The New York Times*, (New York, NY: The New York Times Company, April 30, 1999). The New York Times also identified a "rally around the flag" effect of the NATO air campaign: "The NATO bombing that was intended to cripple and demoralize Slobodan Milosevic's military machine has instead invigorated the Yugoslav Army and has helped him heal his long-poisoned relationship with the officers corps, American and NATO officials say. The senior military and intelligence officials said that more than five weeks of bombing had rallied the Yugoslav Army to the defense of their country, sharply increased the willingness of recruits to serve in the military and given senior army officers a mission that they finally feel is legitimate. "The 'rally round the flag' effect in Serbia has been profound," said a Government official who has been studying the Balkans for a decade and attributes the change in army morale to the NATO bombing. "It is not Slobo's war. It is the army defending the country." See Blaine Harden, Steven L. Myers, Steven L., "Bombing Unites Serb Army as It Debilitates Economy," *The New York Times*, (New York, NY: The New York Times Company, April 30, 1999).

[50] For example, during the American Civil War in the 1860s, the Union allowed a certain number of specially licensed traders to buy Confederate cotton on the Mississippi river and re-sell it to Union manufacturers. In Operation ALLIED FORCE, France has blocked efforts to seal Yugoslavian ports in Montenegro with a naval blockade, alleging lack of international legal authority and consideration for a possible Russian reaction.

[51] Donald Lossman is the J. Carlton Ward Jr. Distinguished Professor of Economics at the Industrial College of the Armed Forces (ICAF) at Fort McNair, Washington, DC.

[52] Donald L. Losman, "Going Nowhere: Sanctions are Bad Politics, Bad Economics, and Poor Diplomacy; So Why Do We Use Them?," *Across the Board*, (New York, Copyright Conference Board, Inc., April, 1996), 4.

[53] General Colin Powell espoused this view during Operation Desert Storm, making him a "military dove" according to some authors like Harvard's Bernard Trainor (*The General's War*). This may be unfair though - perhaps Powell meant "work" to mean any of a number of things besides, or in addition to, getting Iraq to get out of Kuwait. See discussion of sanction efficacy testing.

[54] "Large N" refers to a large number of data points for statistical analysis. In physical sciences, 30 data points are often enough to assume a normal distribution, however, social science data often has more problems with the data, so an "N" of 115 may not be very many.

[55] Robert A. Pape, "Why Economic Sanctions Do Not Work," *International Security*, (Cambridge, MA: Harvard University and the Massachusetts Institute of Technology, Fall, 1997), 92.

[56] Ibid, 106.

[57] Rogers is particularly critical of US delay in targeting Haitian political elites with designer financial restrictions (see Executive Order at Appendix E).

[58] Elizabeth S. Rogers, "Using Economic Sanctions to Control Regional Conflicts, " *Security Studies*, (London, England: Frank Cass, Summer, 1996) Table 1.

[59] Operation MARKET GARDEN was the World War II allied airborne invasion of Holland in 1944. The operation was the basis for the book by Cornelius Ryan entitled *A Bridge Too Far*. The popular movie of the title name starred Robert Redford and Gene Hackman in the early 1970s.

[60] Donald L. Losman, "Going Nowhere: Sanctions are Bad Politics, Bad Economics, and Poor Diplomacy; So Why Do We Use Them?," *Across the Board*, (New York, Copyright Conference Board, Inc., April, 1996), 4.

[61] The methodological conundrum is how to code a sanction event if it backfires and result in war (for example), when in fact, the sanctions were meant to accomplish other policy objectives without resorting to war. This is more than a failure, so its statistical treatment is problematic.

[62] A thorough study of the efficacy of sanctions in satisfying domestic interest groups of the imposing nation is needed to broaden understanding in this field of social science.

[63] Donald L. Losman, "Going Nowhere: Sanctions are Bad Politics, Bad Economics, and Poor Diplomacy; So Why Do We Use Them?," *Across the Board*, (New York, Copyright Conference Board, Inc., April, 1996), 4.

[64] Afghani Mujhadeen fighters armed by the US under the "Reagan Doctrine" were probably far more effective in convincing the Soviets to leave Afghanistan than limited trade sanctions and the US boycott of the 1984 Olympics.

[65] Gary C. Hufbauer, *Financial Sanctions: The Nature of the Tool and Preliminary Recommendations*, (Washington, DC: Institute for International Economics, January 11, 1996), 4.

[66] David A. Baldwin, *Generic Sanctioning Methodology: An Analytical Framework*, (Washington, DC: Unpublished Manuscript, December 21, 1997).

[67] Ibid. Baldwin warns that the nonuse of economic sanctions - the conduct of business as usual as usual - may be costly and should be evaluated like any other policy option."

[68] Thomas E. Ricks, and Carla Anne Robbins, "NATO Develops a Plan to Dispatch Troops into Kosovo after Bombing," *The Wall Street Journal*, (New York, NY: Dow Jones and Company, May 5, 1999). The article summarized current NATO ground offensive planning in Operation ALLIED FORCE. "Gen. Clark has been briefed on the plan several times in recent days, ordering changes as it has developed. Most significantly, the original concept presented to him called for as many as 90,000 troops -- a level he rejected, saying that NATO's political leaders would never approve such a large force. The final plan was devised by a mixture of officers assigned to NATO and a group sent to Belgium from the Army's School of Advanced Military Studies at Fort Leavenworth, Kan. -- known half-mockingly in Army circles as the 'Jedi knights'."

[69] Wayne Green, (Fort Leavenworth, KS: Remarks to SAMS Class, May 7, 1999).

[70] David A. Baldwin, *Generic Sanctioning Methodology: An Analytical Framework*, (Washington, DC: Unpublished Manuscript, December 21, 1997).

[71] Donald G. Boudreau, "Economic Sanctions and Military Force in the Twenty First Century," *European Security*, (London, England: Frank Cass, Volume 6, Number 2, Summer, 1997), 38. Baldwin does not concur though, using logic similar to the argument posed regarding the Athenian sanctions against Megara. See David A. Baldwin, *Economic Statecraft*, (Princeton, NJ: Princeton University Press, 1985), 168.

[72] Conspiracy theorists would then probably also have to address US military unpreparedness at Pearl Harbor, and in the Philippines. If US policy makers really sought to induce a war with Japan, would they simultaneously tolerate disastrously lax military readiness?

[73] If sanctions lead to negative unintended consequences, the issue is how to code the event which is essentially a double failure.

[74] Army Times, "The Far East: A Strong Deterrent," *Army Times*, (Springfield, VA: Gannett, April 5, 1999), 6.

[75] David E. Weekman, "Sanctions: The Invisible Hand of Statecraft," *Strategic Review*, (Boston, MA: United States Strategic Institute, The Center for International Relations, Boston University, Winter, 1998) 39. Weekman points out that the "debate" over economic sanctions does not make much sense because sanctions are usually but one component of any foreign policy action.

[76] French justification for blocking full enforcement of the Serbian economic embargo relates to concern over potential Russian reaction to a Montenegrin blockade.

[77] John C. Sharfen, *The Dismal Battlefield*, (Annapolis, MD: Naval Institute Press, 1995), 9.

[78] William I. Robinson, "Making the Economy Scream," Multinational Monitor, (Washington, DC: Corporate Accountability Research Group, December, 1989), 22.

[79] Gary Hufbauer, and Kimberly Elliott, "Qualified Success: Financial Sanctions and Foreign Policy," *Harvard International Review*, (Cambridge, MA: Harvard International Relations Council, Volume X, Number 5, June/July, 1988), 9.

[80] The term financial restriction is used rather than financial operation on purpose. A financial operation implies the use of financial restrictions, and other measures interacting with financial markets, in a distributed fashion. Financial operations link the application of specific financial restrictions, in concert with other elements of national power, to the strategic goals of the coercive campaign

[81] Richard J. Ellings, *Embargoes and World Power: Lessons from American Foreign Policy*, (Boulder, CO: Westview Press, 1985), 117.

[82] Mahvash Allerasool, *Freezing Assets: The USA and the Most Effective Economic Sanction*, (London, England: St. Martin's Press, 1993), 189.

[83] Richard J. Ellings, *Embargoes and World Power: Lessons from American Foreign Policy*, (Boulder, CO: Westview Press, 1985), 118. The US had run up trade surpluses with the "victorious" European powers during the war, which were of course financed by net borrowing from the US. European sentiment in the matter during the

"roaring twenties" was based upon the fact that the US seemed to be enjoying the benefit from a war in which Europeans bore the brunt of the costs.

[84] George B. High, *US Policy on Expropriation in Latin America: Hindrance or Boost to a Mature Partnership in the Hemisphere*? **[SECRET]**, (Carlisle Barracks, PA: US Army War College, March 19, 1973), 46. Note: No classified information is incorporated into this monograph.

[85] Gary C. Hufbauer, *Financial Sanctions: The Nature of the Tool and Preliminary Recommendations*, (Washington, DC: Institute for International Economics, January 11, 1996), 8.

[86] Goldman, Sachs "went public" in the world's largest initial public offering (IPO) in May of 1999.

[87] Interestingly, and perhaps significantly, Kissinger was dual hatted as the President's National Security Advisor as well.

[88] Gary C. Hufbauer, Jeffrey J. Schott, and Kimberly A. Elliott, *Economic Sanctions Reconsidered*, Volume II, (Washington, DC: Institute for International Economics, 2d Edition, 1990), 314.

[89] At one point in the crisis, ITT provided a written report the US State Department recommending precise steps for the administration to take to destabilize Allende and support a military coup.

[90] Ibid, 317.

[91] Michael J. Kryzanek, *U.S.-Latin American Relations*, 2nd Ed, (New York, NY: Praeger, 1990), 111.

[92] William I. Robinson, "Making the Economy Scream," Multinational Monitor, (Washington, DC: Corporate Accountability Research Group, December, 1989), 22.

[93] Gary C. Hufbauer, Jeffrey J. Schott, and Kimberly A. Elliott, *Economic Sanctions Reconsidered*, Volume II, (Washington, DC: Institute for International Economics, 2d Edition, 1990), 318-319.

[94] Gary C. Hufbauer, Jeffrey J. Schott, and Kimberly A. Elliott, *Economic Sanctions Reconsidered*, Volume I, (Washington, DC: Institute for International Economics, 2d Edition, 1990), 153.

[95] The administration cites Iranian Premier Sadeq Ghotbzadeh's threat to destabilize US financial markets as justification for invocation of IEEPA. Many challenge this claim as a political pretext.

[96] Allerasool, Mahvash, *Freezing Assets: The USA and the Most Effective Economic Sanction*, (London, England: St. Martin's Press, 1993), 105.

[97] Ibid, 88, 94.

[98] Ibid, 67-69.

[99] Ibid, 185.

[100] Iraq asserted irridentist claims to Kuwait as a lost province (Kadhima), and their actions appear related to economic goals such as obtaining Kuwaiti oil reserves and forcing OPEC to cut production and raise world oil prices. See Gary C. Hufbauer, Jeffrey J. Schott, and Kimberly A. Elliott, *Economic Sanctions Reconsidered*, Volume I, (Washington, DC: Institute for International Economics, 2d Edition, 1990), 283-287.

[101] Bashir Al-Samarrai, with George A. Lopez, and David Cortright, (Editors), (*Economic Sanctions*. Boulder, CO: Westview Press, 1995), 133-134.

[102] Ibid, 137.

[103] Gary C. Hufbauer, Jeffrey J. Schott, and Kimberly A. Elliott, *Economic Sanctions Reconsidered*, Volume I, (Washington, DC: Institute for International Economics, 2d Edition, 1990), 20.

[104] In contrast to US experience with IEEPA and Khomeini's Iran, British Courts struck down extra-territoriality application of IEEPA in a precedent setting case involving Bankers trust (BT). Hence forth, IEEPA would need multi-lateral endorsement to be effective.

[105] Gaddafi is reported to be affected by mental illness.

[106] The Wall Street Journal, "Turning Gadhafi," *The Wall Street Journal* (New York, NY: Dow Jones & Company, April 7, 1999) A22.

[107] In an example of a forgone chance to employ a golden parachute for Panamanian dictator Manuel Noriega, President Bush refused to consider dropping Noriega's drug charge indictments if he stepped down, even though former President Reagan had once approved this coarse of action (COA). See Thomas Donnely, Margaret Roth, and Caleb Baker, *Operation Just Cause*, (New York, NY: Lexington Books, 1991), 30-34.

[108] Elizabeth S. Rogers, "Using Economic Sanctions to Control Regional Conflicts," *Security Studies*, (London, England: Frank Cass, Summer, 1996), 62-63.

[109] David E. Weekman, "Sanctions: The Invisible Hand of Statecraft," *Strategic Review*, (Boston, MA: United States Strategic Institute, The Center for International Relations, Boston University, Winter, 1998), 43.

[110] Multiple sources: See bibliography references to interviews and email exchanges with Kretchik, Baumann, and Steele.

[111] Walter E. Kretchik, Robert F. Baumann, and John T. Fishel, *Invasion, Intervention, "Intervasion:" A Concise History of the US Army in Operation Uphold Democracy*, (Fort Leavenworth, KS: US Army Command and General Staff College Press, 1998),79.

[112] David E. Weekman, "Sanctions: The Invisible Hand of Statecraft," *Strategic Review*, (Boston, MA: United States Strategic Institute, The Center for International Relations, Boston University, Winter, 1998), 43-44. Haitian junta leader General Raoul Cedras reportedly occupied the Shah's former residence of exile in Panama. Twenty-three of Cedras' relatives were provided safe passage to the US with living expenses.

[113] Tim Cooney, (Legal Counsel, US Office of National Drug Control Policy), (Washington, DC: Interview, March 10, 1999).

[114] Ibid.

[115] Barry R. McCaffery, (Director, Office of National Drug Control Policy (ONDCP), Executive Office of the President), (Fort Leavenworth, KS: SAMS Seminar, April 16, 1999). Many economists such as Nobel prize winner Milton Friedman argue that narcotics suppliers will ultimately adapt to whatever measures a free society can use against them, and that only "demand-side" reduction policies will be effective.

[116] Tim Cooney, (Legal Counsel, US Office of National Drug Control Policy), (Washington, DC: Interview, March 10, 1999).

[117] Donald G. Boudreau, (Director, Sanctions Branch, US Department of Defense Joint Warfare Center), (Dahlgren, VA: Interview, April 27, 1999).

[118] Dale Eikmeier, (SAMS Seminar Leader), (SAMS Seminar Discussions), 1998-1999.

[119] Andy Kessler, "If Only We Could Turn Back the Clock," *The Wall Street Journal* (New York, NY: Dow Jones & Company, March 23, 1999), A22.

[120] Martin Shubik, "Unconventional Methods of Economic Warfare," *Conflict*, (Crane, Russak & Company, Inc., Volume 1, Number 3, 1979), 222.

[121] Martin Shubik, "Unconventional Methods of Economic Warfare," *Conflict*, (Crane, Russak & Company, Inc., Volume 1, Number 3, 1979), 215.

[122] David A. Baldwin, *Generic Sanctioning Methodology: An Analytical Framework*, (Washington, DC: Unpublished Manuscript, December 21, 1997).

[123] Martin Shubik, "Unconventional Methods of Economic Warfare," *Conflict*, (Crane, Russak & Company, Inc., Volume 1, Number 3, 1979), 222.

[124] The monograph author owes a debt of gratitude for development of this idea since 1993 to colleagues and friends in the Financial Engineering Program at the MIT Sloan School of Management, as well as the Department of Social Sciences at the US Military Academy. Specific credit for helping to gestate these ideas goes to Andrew Lo, Jeffrey Chua, Kosrow Mehrzad, Jim Hosker, Kohei Wakayama, Dean Dudley, Mike Meese, Joe Gleeson, Bob Jones, John Kem, Jaime Gayton, John Ferrari, and Kevin Foster.

[125] Indicators of susceptibility to financial crisis include: International reserves, real exchange rate, export performance, credit growth, fiscal deficit, credit to public sector, domestic inflation, real GDP growth, employment situation, trade balance, money growth, and change in stock market prices.

[126] Gary C. Hufbauer, and Daniel H. Rosen, *Can Sanctions Be Used to Induce a Financial Crisis? A Consideration of Issues and Models*, (Washington, DC: Institute for International Economics, December 15, 1996), 14.

[127] Ibid, 15.

[128] Imagine contemporary US financial market reaction to the kidnapping or assassination of Federal Reserve Board Chairman Alan Greenspan. Even passing comments by the Chairman of the Federal Reserve often move global financial markets. Securities and Exchange Commission (SEC) "...Chairman Levitt says he ran into Fed Chairman Greenspan "and I said to him, 'How are you, Alan?' And he looked at me carefully, inscrutably, and said [only half jokingly] 'I'm not allowed to say'." See The Wall Street Journal, "Minor Memos," *The Wall Street Journal*, (New York, NY: Dow Jones & Company, May 7, 1999), A1.

[129] Peter, F. Druker, "The Global Economy and the Nation State," *Foreign Affairs*, (New York, NY: Council on Foreign Relations, September/October, 1997), 169.

[130] Andrew Lo, (Director, Financial Engineering Program, MIT Sloan School of Management), (Cambridge, MA: Interview, May 3, 1999). Lo confirmed my recollection of events.

[131] Ibid, 223.

[132] Seignorage is income derived by the state through the money creation process.

[133] Andrew Lo, Director, (Financial Engineering Program, MIT Sloan School of Management), (Cambridge, MA: Class Lecture, Spring, 1995).

[134] An autarky is a state of economic isolation and self sufficiency.

[135] Thomas Niblack, (US Foreign Service Officer and Assistant Professor of International Relations, US Military Academy), (West Point, NY: Interview, March 28, 1999). In 1989, researcher Haider Ali Khan concluded that in regards to sanctions, "...it is not clear what positive effects they will have in terms of eradicating apartheid." See Haider A. Khan, *The Political Economy of Sanctions Against Apartheid*, (Boulder, CO: Lynne Rienner Publishers, 1989), 76. Nearly a decade later, South Africa abolished apartheid, electing former African national Congress (ANC) leader Nelson Mandela as President in 1994. Economic sanctions imposed on Rhodesia a decade earlier were notoriously leaky, and the ultimate political solution of majority rule not necessarily correlated with the sanctions. Interestingly in the case of UN sanctions against white minority ruled Rhodesia, the US voted for the sanctions in the UN, but then was unable to implement them due to Congressional legislation referred to as the Byrd amendment in 1971. The Black Congressional caucus sued to overturn the Byrd amendment as a US violation of the UN Charter to which it was a signatory; but the courts declined to interfere saying that Congress can "...denounce a treaty if it sees fit to do so." President Carter was able to pursued Congress to change the law in 1977. See Harry R. Strack, *Sanctions: The Case of Rhodesia*, (Syracuse, NY: Syracuse University Press, 1978), 149.

[136] Global currency markets are called the foreign exchange markets, and over $1 trillion of foreign exchange are traded daily. Governments "intervene" in such markets by buying (or selling) one currency with (or for) another currency, or precious metal such as gold.

[137] Paul R. Krugman, "Soros Plea," *The Dismal Science*, (Cambridge, MA: MIT Web Server, http://web.mit.edu/krugman/www.soros.html, April 14, 1999), 1.

[138] The hedge funds reportedly had borrowed in Yen and began to ostentatiously short the Hong Kong dollar and stock market, spreading rumors of an imminent devaluation of the Chinese Rinminbi. Cash obtained in the short positions was deposited in various high yielding assets including Russian bonds and US junk bonds.

[139] Causing massive inflation in a target country does not necessarily lead to economic ruin, nor a change in target state policies. For example, in 1992, Yugoslavia endured the second worst inflation in history, achieving a *monthly* rate of 313 million percent! This inflation's origin was (former banker) Milosevic's plundering of the Yugoslav central bank when the Serbian parliament secretly issued $1.4 billion in credits to friends of Milosevic, half of all of the new money that the Yugoslav central bank planned to emit that year. Further seigniorage through the printing of money financed Serbian initiatives and allowed connected Serbian elites to profit from rising prices and black market activities related to the economic sanctions against Serbia and Montenegro. See Steve H. Hank, "Yugoslavia Destroyed Its Own Economy," *The Wall Street Journal*, (New York, NY: Dow Jones and Company, April 28, 1999), A18..

[140] Andrew Lo, (Director, Financial Engineering Program, MIT Sloan School of Management), (Cambridge, MA: Interview, May 3, 1999). Lo tentatively concurred with my assessment.

[141] Martin Shubik, "Unconventional Methods of Economic Warfare," *Conflict*, (Crane, Russak & Company, Inc., Volume 1, Number 3, 1979), 224.

[142] Time inconsistency refers to the phenomena existent when an agent proposes a coarse of action which will be, on its face, hard to carry out later. For example, threatening to spank your children if they do not pick up their toys is time inconsistent (assuming that one is reticent to spank his or her children).

[143] The idea here is very similar to the idea of sending a token US military force to a region quickly to deter further aggression by another state. For example, in August of 1990, Iraq could have overrun the 82d airborne division and occupied Saudi oil fields, but they chose to avoid such a confrontation with the US. In a currency attack that places treasure at risk, the US is credibly signaling that it is going to go through with the action of coercing the target state. If the US backs away from its coercion, it stands to lose money in financial markets, thus the target state has reason to believe the US is serious.

[144] David A. Baldwin, *Economic Statecraft*, (Princeton, NJ: Princeton University Press, 1985), 107.

[145] James D. Fearon, *Threats to Use Force: Costly Signals and Bargaining in International Crises*, (Ann Arbor, MI: UMI Dissertation Services, 1994), 109.

[146] Robert Jones, (Masters of National Security Candidate, US Naval College of Command and Staff), (Newport, RI: Interview, April 16, 1999).

[147] Thomas E. Ricks, Carla A. Robbins, and Gerald F. Seib, "War Bombs Hit Home of Milosevic," *The Wall Street Journal*, (New York, NY: Dow Jones & Company, April 23, 1999), A11.

[148] This position is formally known as the Special Assistant to the President for National Security Affairs.

[149] Ibid.

[150] Ibid, A13.

[151] Robert A. Pape, "Coercion and Military Strategy: Why Denial Works and Punishment Doesn't," *Journal of Strategic Studies*, (London, England: Frank Cass, Volume 15, Number 4, December, 1992), 434

[152] Robert A. Pape, "Coercion and Military Strategy: Why Denial Works and Punishment Doesn't," *Journal of Strategic Studies*, (London, England: Frank Cass, Volume 15, Number 4, December, 1992), 435.

[153] Democracies may have trouble playing this sort of game because a free press will report the merciless nature of the punishment to a public unschooled in game theory, but sensitive to innocent human suffering. Recall policy maker sensitivities in 1991 over press coverage of the deaths of 300 Iraqis in the attack on the Al Firdos command center bunker in Baghdad that doubled as a civilian bomb shelter. According to *The Gulf War Air Power Survey*, US policy elites such as Colin Powell sought a quick end to the pursuit and destruction of the Iraqi Army fleeing Kuwait not out of sensitivities to public reaction to the slaughter (or real politic concerns vis a vis Iran), <u>but rather in ***anticipation*** of such reaction</u>. In Operation ALLIED FORCE against Serbia in April of 1999, NATO's

nineteen member nations refused SACEUR General Wesley Clark's initial planning request to target what he called "...the three pillars of Milosevic's Strength: the army, the Secret Police, and the media." NATO fell all over itself in April of 1999 trying to apologize for attacking a Serbian train accidentally hit when the "real" target was the bridge itself - a game theorist would argue that NATO should have publicly celebrated the accidental "two-for-one" strike as reminiscent of allied action portrayed in the popular movie *Bridge over the River Kwai*, starring Alec Guiness. Later, SACEUR spokesman Commodore David Wilby "disappeared from public view" after he pronounced Serb TV a legitimate target. A week later, NATO democracies authorized targeting of the Serb media. German Foreign Minister Joshcka Fischer summed it up saying that it takes time "...for democracies to realize what they are fighting for and how dangerous the enemy is." See also The Wall Street Journal, "How NATO Decided It Was Time to End Its 'Gentlemanly War," *The Wall Street Journal*. (New York, NY: Dow Jones & Company, April 27, 1999), A1, and A6.

[154] A privately held firm will not have publicly traded stock, but it often will have outstanding bonds (debt instruments). Debt financing exceeds equity financing across the global economy, and this is even more true in developing nations.

[155] Robert Jones, (Masters of National Security Candidate, US Naval College of Command and Staff), (Newport, RI: Email Exchange, April 9, 1999).

[156] Attaching means to confiscate seized or blocked assets, an action allowed under the TWEA.

[157] The US seized the Bayer aspirin trademark from German investors in World War I. A German firm bought it back in the 1990s for over a billion dollars. In this unique scenario, the US government could make money in both the financial attack on a target country's financial securities, as well as the sale of assets (including intellectual property) seized under TWEA.

[158] The reader may be ill at ease with the notion that the US could lose money as it unwinds its target state financial positions *after the target state acquiesces to political demands*. This realization should reinforce the popular economic notion of TINSTAFL (there is no such thing as a free lunch). One underlying assumption of corporate neutralization is that the US has foreign policy objectives over which it is already prepared to risk blood and treasure in order to achieve. Modeling of the political and financial market response functions under corporate neutralization operations is needed to enhance this discussion.

[159] Terzah, Ewing, "Oil Prices Slip Amid Mixed Signals About Iraq," *The Wall Street Journal*, (New York, NY: Dow Jones, Inc., February 3, 1998), C17.

[160] There would of course be counter party risk (financial exchanges may be unable to function), legal risk (identified parties might be subject to prosecution, litigation, and asset freezing), and military risk (the US is likely to retaliate if it identifies responsible individuals, groups, or states).

[161] Clearly, economists would label this phenomena a "market failure," that is an exception to Adam Smith's (see his eighteenth century book *Wealth of Nations*) "invisible hand" that promotes the general good through the pursuit of individual self interest.

[162] Gary Hufbauer, and Kimberly Elliott, "Qualified Success: Financial Sanctions and Foreign Policy," *Harvard International Review*, (Cambridge, MA: Harvard International Relations Council, Volume X, Number 5, June/July, 1988), 9.

[163] See quote in heading to Chapter 4. The idea here is again related to the informational asymmetry inherent in problems of time inconsistency. US policy makers know if they are serious about a threat to use force, while the target state can only guess. If they are serious, then attacking currencies, sovereign debt, and corporate securities of a target state is like doubling down on a bet they know they can win. Imagine if, during the American Civil War, the Union had attempted to finance its war effort by shorting Confederate war bonds sold and traded in Europe. Confederate war bonds were nineteenth century derivative instruments, allowing holders to be paid in their choice of British Pounds Sterling, French Francs, or bales of cotton. They became worthless after the war.

[164] Many analysts suggest that US use of nuclear tactics against Japan in World War II lent credibility to the American nuclear deterrent during the Cold War.

[165] Peter, F. Druker, "The Global Economy and the Nation State," *Foreign Affairs*, (New York, NY: Council on Foreign Relations, September/October, 1997), 169.

[166] Martin Shubik, and J. Hoult Verkerke, "Open Questions in Economic Warfare," *Journal of Conflict Resolution*, (London, England: Sage Publications, Volume 33, Number 3, September, 1989) 497.

[167] Theorist Edward Luttwack claims *first* use of this term, but this is not strictly true.

[168] James J. Schneider, *Theoretical Paper No. 3: The Theory of Operational Art*, (Fort Leavenworth, KS: School of Advanced Military Studies, U.S. Army Command and General Staff College, March 1, 1988), 8.

[169] James J. Schneider, *Vulcan's Anvil: The American Civil War and the Emergence of Operational Art*, (Fort Leavenworth, KS: School of Advanced Military Studies, U.S. Army Command and General Staff College, June 16, 1991), 4-8.

[170] Ibid, 6-23.

[171] Ibid, 30.

[172] James J. Schneider, *Theoretical Paper No. 3: The Theory of Operational Art*, (Fort Leavenworth, KS: School of Advanced Military Studies, U.S. Army Command and General Staff College), March 1, 1988),14.

[173] James J. Schneider, *Vulcan's Anvil: The American Civil War and the Emergence of Operational Art*, U.S. Army Command and General Staff College, 16 June 1991, 38.

[174] Ibid, 39.

[175] Ibid, 40.

[176] Ibid, 45-46.

[177] Ibid, 53-54.

[178] Ibid, 55-58.

[179] Ibid, 58.

[180] Ibid, 66.

[181] Gary C. Hufbauer, *Financial Sanctions: The Nature of the Tool and Preliminary Recommendations*, (Washington, DC: Institute for International Economics, January 11, 1996), 14.

[182] "Fiat" is Latin for "let it be." Fiat money is "paper" money backed only by the full faith and credit of the sovereign issuer. According to monetary theory, fiat money's value is derived primarily from the quantity in circulation, and secondarily by perceptions of the money holding public as to the ability and intentions of the sovereign to maintain price stability via control of the quantity of money. In other words, "In Greenspan We Trust." Consolidation of fiat money is underway in the 1990s. Most member nations of the EU have adopted a single currency called the Euro, and since the Mexico currency crisis of 1994, there has been serious discussion in Latin America about following the EU's lead and "dollarizing" their economies. In April of 1999, President Clinton's Treasury Secretary Robert Rubin and his deputies have been somewhat cool to the idea in public.

[183] Observation of college students during course of teaching economics and finance at the US Military Academy from 1995-1998.

[184] Commercial and infomercials of the 1990s (notably name brand firms such as The Money Store and DiTech Funding) routinely seek to convince home owners to refinance loans to take advantage of macroeconomic shifts in interest rates, tax implications, and other criteria.

[185] President Clinton has offered to consider investing of portions of the Social Security Trust Fund in equities, nineteen years after Presidential Candidate Ronald Reagan proposed the idea in the face of virtually uniform criticism by opponents and the press who likened the idea to gambling.

[186] The Wall Street Journal, "Turning Gadhafi," *The Wall Street Journal* (New York, NY: Dow Jones & Company, April 7, 1999) A22.

[187] Mahvash Allerasool, *Freezing Assets: The USA and the Most Effective Economic Sanction*, (London, England: St. Martin's Press, 1993), 189.

[188] Robert A. Doughty, and Harold E. Raugh, "Embargoes in Historical Perspective," *Parameters*, (Carlisle, PA: US Army War College, Volume XXI, Number 1, Spring, 1991), 21.

[189] Army Materiel Command, *LOGCAP Battlebook*, (Alexandria, VA: US Army Materiel Command, December 6, 1997), 17.

[190] Robert, Jones, (Masters of National Security Candidate, US Naval College of Command and Staff), (Newport, RI: Email Exchange, April 9 and 27, 1999). Jones points out that "Army FM 34-130 (Intelligence Preparation of the Battlefield (IPB)) under strategic and operational IPB, under economy, simply lists 'economies' - very generic and highlights the lack of appreciation or understanding we have in targeting economic COGs (Centers of Gravity) outside of traditional infrastructure we can bomb." Jones observation of a doctrinal void is buttressed by lack of any reference to financial operations in the Army's *FM 100-5 (Operations)*, or the 1998 effort to revise this manual.

[191] The Army already has a skill identifier for officers with demonstrated skill in economics: 6C - "Army Economist."

[192] One clear "doctrinal" precedent (by law) is that the Department of State is the pre-eminent agency player in the area of foreign policy formulation.

[193] Bob Davis, "Policy Makers Debate How to Handle the Next Kosovo," *The Wall Street Journal*, (New York, NY: Dow Jones and Company, April 30, 1999),A16. Mr. Friedman later regretted the McDonalds metaphor after Serbian McDonalds franchises were first closed due to rioting against NATO air attacks, then reopened due to popular demand in April of 1999 during Operation ALLIED FORCE. He now feels he should have used the "Starbucks" metaphor instead.

[194] Ibid.

[195] See Donnely, Thomas, Roth, Margaret, and Baker, Caleb. *Operation Just Cause*. New York, NY: Lexington Books, 1991.

[196] Hull, John C., *Options, Futures, and other Derivative Securities* (2d Edition). Englewood Cliffs, NJ: Prentice Hall, 1993), 224-225. Formula applies to European Options, as does European Put-Call Parity. A European option does not allow for "early exercise" prior to expiration.

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